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**STATE FINANCING
OF
PRIVATE ENTERPRISE
IN POST-WAR INDIA**

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Dedication

To

My Mother

and

My Grandmother

P R E F A C E

This book is a study of government financial assistance to private enterprise in post-war India in the context of relevant international developments of recent years. We lack a comprehensive work on the extending sphere of State activity in respect of the financing of private business effort in this country. The small output of what has been written on this highly important, and no less interesting, subject so far lies scattered and is fragmentary in character. The purpose of this work is to fill this gap and present a comprehensive, as far as possible detailed, and critical analysis of government financial help variously given to private enterprise after World War II in pursuance of a mixed-economy policy.

An earlier draft, completed in December, 1952 and entitled "State Financing of Private Enterprise after World War II", was accepted by the Calcutta University as a thesis for the D.Phil. Degree in Economics towards the end of 1954. It would have been ideal, indeed, if an exhaustive survey could be made of State aid from its very beginning right upto the present day. But even if the innumerable difficulties inherent in the implementation of such a theme could be overcome, the result would have been an epic and no thesis. These considerations, coupled with another, namely that, several published works containing valuable details of pre-war and war-time aid (*e.g.*, the works of Dr. S. K. Basu, Dr. P. S. Lokanathan, Messrs. Nanavati and Anjaria, and several Reserve Bank publications) are available to us, have led me to restrict the horizon of my enquiry to the period after the Second World War, which is by far the most significant and eventful of all periods in the history of State financial aid to private business in India. Nevertheless, necessary links with the past have all through been maintained so as to impart a continuous quality to the account.

The watchful reader will come across certain imperfections here and there in the present work. These have been due to several unavoidable factors : the general character of the thesis and the consequent inadequacy of attention given to finer details in several chapters ; incomplete data supplied by a few State Administrations ; discouraging and regrettable attitude of certain Departments in several (fortunately minor) States towards my inquiries and requests for data ; the virtual impossibility of rendering certain statistics of the original thesis

(written in 1952) up-to-date in course of a few months (thanks to the excessive delay that is made by Government Departments in general* *in this country* in furnishing information to honest research workers) ; and the widely known fact that a book on any aspect of current Indian economic life, however up-to-date in its manuscript form, is apt to become a bit back number by the time it reaches the reader in printed shape owing to the quickening of the pace of economic change in recent years. But this, I believe, has not detracted seriously from the utility of this study, for great pains have been taken in order to ensure that no outstanding event or development of the last ten years is omitted. With due apology to the Governments concerned, I should further like to say that if there is anything looking like misrepresentation of State activities or policies anywhere in this work, it is purely accidental and far from deliberate.†

I wish to record my debt to the following persons and institutions who were variously associated with the preparation of this book : Dr. Saroj Kumar Basu, M.A., PH.D., Professor of Industrial Finance and Dean of the Faculty of Commerce, Calcutta University, who guided the writing from start to finish ; Dr. Satyendra Nath Sen, M.A., PH.D. (Lond.), Reader in Economics, Calcutta University, who went through several chapters of this book in their manuscript form and immensely benefited me with suggestions for improvement ; the Government of India and those State Governments who were kind enough to furnish me with the necessary facts and figures ; the authorities of the Industrial Finance Corporation of India, the Rehabilitation Finance Administration, the Madras Industrial

* I ought not to have any hesitation in admitting that the Union Government Departments furnish, however, an important exception in this respect.

† In this connection I want to make certain things clear at the very outset. First, I have included co-operatives in the category of private enterprise, for co-operative enterprise is essentially a modified form of private enterprise. Secondly, I have discussed the Industrial Credit and Investment Corporation as a private agency (in Chap. II) as well as as a government agency (in Chap. VI) because a large sum of State money has been employed in that body. Finally, I have treated it in my analysis as virtually a sort of industrial development corporation, for its functions indicate that it is undoubtedly more than a mere industrial finance corporation having the power to supply share capital.

Investment Corporation, the Travancore Credit Bank and the Post-War Services Reconstruction Fund Trust, U.P.; the Librarian of the National Library, Calcutta; the Government of Israel; the Institut für Weltwirtschaft an der Universität Kiel, West Germany; Mr. F. V. Mendelssohn, Consul-General for West Germany in India during 1951, who helped me to contact the Institut; the Office of the Australian High Commissioner in India, New Delhi; and the Indian High Commissioner in Pakistan, Karachi. My thanks are also due to Dr. J. P. Niyogi, M.A., PH.D. (Lond.), Head of the Economics Department and Minto Professor of Economics, Calcutta University, Prof. Panchanan Chakravarty of the Economics Department, Calcutta University, and Dr. Haragopal Biswas, M.A., D.PHIL., Director of Research, Bengal Chemicals, Calcutta, for the valuable encouragement I received from them throughout my research work, to Prof. Alok Ghose of the Economics Department of the Calcutta University and Sri Pranesh Kar of the Indian Statistical Institute, Calcutta, for their assistance, to the authorities of the *Indian Journal of Economics*, the *Indian Journal of Commerce*, and the *Calcutta Review* for having permitted me to incorporate in this work passages and figures from my articles published in their respective Journals in the last four years, and finally, to my publishers.

No one but myself is, however, responsible for the views expressed in this book.

Calcutta, {
December, 1955 }

ARUN K. DATTA GUPTA

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CHAPTER I

THE FINANCIAL PROBLEM

A firm cannot come into existence without finance. In a monetary economy, bringing together the different factors of production entails money expenditure. But it is not enough to bring the necessary productive factors together. In the simplest possible case,* the problem of production is a two-fold one : production has, first, to be started, and then, maintained. Once production commences, the firm has to continue production. In order that output may continue to be produced, the services of the productive factors must be continuously available to the firm. This continuous availability of factor services also involves outlay, and that of a recurring type. Thus, the start as well as the maintenance of production has to be financed.

But the problem of production is not as simple as that. For every good and service there must be a best possible way of production in a given situation. Usually, the firm fails to produce in the best possible way at the very outset. In course of time it tries to arrive at this particular way through trial and error. And try it must, for the entrepreneur knows full well that he cannot attain the minimum cost per unit and thus earn the maximum profit for himself without producing his output in the best possible way. Here, again, a two-fold problem has to be solved. The best possible way of producing a commodity implies two things. The best possible combination between factors has to be introduced

within the firm, and the firm itself has to reach the best possible size, known as the 'optimum' size. A commodity can be produced by factors combining in different proportions, out of which one usually emerges as the optimum proportion or combination in a given situation. The firm seeks to arrive at this optimum proportion with an eye to the maximum profit, and this search for the optimum proportion between factors cannot bear fruit without sufficient funds. At the same time, the firm also strives to attain the most desirable size. Costs are kept low not by clinging to the optimum proportion alone. A commodity can be said to be produced in the best possible way, when its production is carried on the best possible scale with the best possible combination of factors. But the expansion of the firm also requires finance.

Thus, in a less simplified case, the firm is involved in money expenditure so that it may get a start and produce with the optimum combination between factors on an optimum scale. But in practice, the problems of a firm are more numerous and complicated. Ours is a dynamic world. Values, methods and circumstances are changing constantly, in different degrees, of course, in different parts of this world. The assumption of a given, never-changing situation in these circumstances is as unrealistic as it can be. As soon as the firm has been able to introduce, partially or completely, the best and widely known combination between factors, it finds that a still better combination is being discussed by scientists, or that the given situation itself having undergone a change, the cherished combination has ceased to be an ideal one in the new set of circumstances.

Thus, the firm has to adjust its techniques constantly to the new developments as they occur. Its search for the optimum scale proves to be a chase of the will-o'-the-wisp, for due to constant changes in the circumstances, the optimum size of to-day ceases to be the optimum to-morrow. The consequent re-adjustments, which are essential if the firm has to survive, earn the maximum profit and also be of the greatest utility to the community, cannot be made without finance.

In this way, finance is seen to be the crucial factor in the establishment and successful operation of the firm. The flotation and efficient operation of the firm are essential in a fully employed economy for ensuring an efficient allocation and utilisation of resources, in an under-employed economy for realising both an improved utilisation of already employed factors and an increase in factor employment. Financial stringency in a capitalist economy will deprive the community of all these benefits. There is another consideration. Simultaneously with an improvement in the distribution and employment of resources in the economy, the economy itself grows. Assuming that the entrepreneur is willing enough to commence or expand or maintain production, the financial difficulty will be a major stumbling block in the way of progress.

The problem of finance is not of an identical nature in every part of the world. Some parts of the world are rich and well-developed, whilst others are relatively backward, poor and under-developed. The financial problem in an advanced country is fundamentally

different from that in a poor, backward country. In a rich, grown-up economy with well-organised money and capital markets, this problem resolves itself ultimately into one of ensuring a better mobilisation and allocation of the available savings of the community amongst different firms in different lines. It has been erroneously argued that a case for governmental aid in such a system lies in the apprehension that the fundamental economic forces of expansion have, as the exponents of the stagnation thesis* have shown, definitely weakened.† In terms of the stagnation thesis, however, the problem of an economy like America is one of deficiency in demand and not in funds for financing business. Apart from created money and external assistance, the eventual source of all types of finance is the savings of the community out of its incomes, and savings are too large rather than too small in such an economic system. The alleged financial gaps from which some firms, particularly the smaller ones, suffer, indicate institutional mal-adjustments preventing an ideal allocation of loanable funds, and not deficiencies for the system as a whole. In so far as there is always a "fringe of unsatisfied borrowers" whose investment plans cannot materialise due to lack of finance, State aid will certainly promote some amount of new investment. But the significance of this small amount in the face of a much larger fall in investment caused by vanishing investment opportunities should not be exaggerated. An extension of State aid to fill the alleged gaps in the private financial mechanism is,

* Developed by the Keynes-Hansen School.

† For such an argument see Fuller, "Government Financing of Private Enterprise" (1948), ch. ii.

therefore, no guarantee of continuous full employment in a rich, mature economy confronted with the problem of excessive savings. The question of financial assistance loses most of its significance under the circumstances. The State can easily tackle the so-called financial difficulty by extending support through government departments and/or specially created agencies. What requires expansion is the size of effective demand.

But in a poor, under-developed economy with a weak, ill-organised finance market, the financial problem is basically different, more difficult and complex. In such an economy there is a deficiency in total savings, for it is a small-income, high-consumption economy. Moreover, whatever savings are available are not all properly tapped and channelled to the productive sectors owing to the unorganised and under-developed state of the finance market. There is thus a two-fold deficiency: an over-all deficiency in savings and an organisational deficiency preventing the best possible distribution of available savings amongst different uses. Again, the firm may not be set up or maintained, not only because the financial problem is there, but also because the demand for its output is depressed owing to which it cannot earn the expected profit. The nature of the demand deficiency in such a system is, however, essentially different from that which a rich economy may face in its advanced years. It is not related to excessive savings and falling marginal propensity to consume. Rather, it is due to insufficient purchasing power in the hands of consumers who are willing enough to purchase. Actual demand may be small, but potential demand is great, because a large part of the basic, not to speak of

the luxury, needs of the people remains unsatisfied. Raising the level of effective demand involves income and employment creation. If the firm under private enterprise cannot reach the goal of production in the best possible way owing only to a lack of current demand, the State can subsidise it to the extent of the price-cost disparity and/or launch on a programme of income and employment generation through public investment. In such a situation, the existence and successful operation of a sizeable public sector is a pre-requisite of the survival of the private sector, or, in other words, mixed economy is the only objective which planning in an under-developed economy must aim at, if it wants to keep private enterprise alive. If, on the other hand, the firm cannot produce in the best possible way due to lack of finance, the state can make funds available to it through its own agencies, besides making all the necessary arrangements for improving the existing financial organisation. In an under-developed country like India, the inability of the firm to get a start or adopt up-to-date productive techniques or expand or maintain the present output level is very often attributable to the inability of the private financial organisation to furnish it with the necessary funds. It is possible for the private financial organisation to show better performance (in India in particular), for there is considerable scope for better mobilisation and distribution of available savings. But the requirements of innumerable firms that exist and that may come into existence in different industries cannot all be met in this way. The State will have to come forward with its own supplies with a view to making good the shortfall in private supplies of investable funds.

But how will the State secure the required funds itself under conditions of insufficient savings? In our country a part—a considerable part, I believe—of the community's savings fails to be mobilised by private agencies, and will continue to be so, even if the private system is able to work up the maximum efficiency, in the current socio-economic situation.* These savings can be tapped by and channelled only through government agencies. In all likelihood there will also occur a better allocation of available savings and a consequently larger satisfaction of the needs of different firms, including private ones, by the deflection of a part of the national savings from the private to the government financial organisation. But can much come out of any programme of State aid, if it is thought that all the requirements of the private sector (along side of which the public sector also must expand) can be met simply by this sort of re-adjustment? In the initial stages of the implementation of a development plan covering both the public and the private sectors, tapping the existing flow of savings and redistributing it amongst different uses according to a well-conceived system of priorities will not be enough. The flow itself—which will, of course, grow through time—will have to be supplemented by outright money creation, for the financial gap cannot be wholly bridged by the savings of foreigners (i.e. foreign assistance). This process of monetary expansion need not continue indefinitely or create inflation. Carrying out plans of capital construction will augment income from the moment of their inception. This income will steadily increase and increase cumulatively. The margin between income and consumption will widen in course of

time. Thus, after the lapse of a period of time the disparity between the demand for and supply of savings will tend to disappear, and this period of time will be a relatively short one provided that the appropriate measures of economic organisation are taken. As the economic system is an under-employed and under-developed one, it contains elements of reserve productive capacity which can be mobilised for constructional work without competing with the firms producing consumption goods. Subsequently, as the capital equipment under construction comes into operation, it will raise the supply of consumption goods. Whether inflation will develop will depend considerably on the ability of the planners to make this period of time in which the programme of capital construction "can become an aid to the output of consumption goods, instead of a competitor with it," a relatively short one.

This discussion may be concluded with a brief reference to the chief objection against State aid. Financial aid by the government has been consciously or unconsciously looked upon by many as one way of staying the alleged disintegration of the private economy in our times. But State financing might as well be regarded as an engine of revolution in the capitalist system. Just as the grants-in-aid to local bodies have become almost everywhere a means of extending central control over local activity, so also State aid to private business is capable of being utilised as a step towards an over-all State control from which socialisation is no great distance. The Temporary National Economic Committee of the U. S. Senate in its final Report (1941) gave vent to similar misgivings in the following words:

“We cannot continue to rely upon government expenditures...to sustain enterprise and private employment unless we are willing to invite eventually some form of the authoritarian State.” This objection against State aid has been voiced forcefully, and particularly, by American economists in recent years.

Thus, to sum up the main argument of this chapter, a high propensity to consume, the existence of unemployed and under-employed resources, inadequacy of total savings in relation to development requirements, and the failure of the private financial organisation to mobilise the whole of available savings and allocate it in the best possible manner are the crucial factors that invest the State with tremendous importance in its role as the financier to private enterprise in the under-developed economy of India. But State aid will inevitably be associated with some amount of State control over private enterprise.

CHAPTER II

GAPS IN THE PRIVATE FINANCIAL MECHANISM OF INDIA

We may now take up the question of the financial difficulties of private enterprise in this country, an analysis of which would immensely facilitate the task of evaluating the different types of government aid actually given to various sectors of private business activity.

Difficulties of private enterprise arising out of several serious deficiencies or gaps in the private financial mechanism constitute an oft-discussed subject in India. But neither have these alleged gaps been measured directly, nor in the current state of our information is it possible to measure them fairly accurately, if at all, so that the amount of State financial assistance which would just suffice may be exactly ascertained. Under the circumstances, any study of these financial gaps must necessarily be content with such an indirect measure of them as can be made from an examination of the following factors:—(1) breadth of the money and capital markets, and under this head, a study of the (a) variety-pattern of financial institutions, (b) degree of inter-relation and co-ordination between the various parts of the system, permitting a smooth inter-part flow of funds and a consequent equalisation of credit conditions throughout the system, and (c) regional distribution of finance agencies; (2) adequacy of total resources of private financial agencies; (3) adequacy of total assistance given by these agencies; (4) interest and other

costs of credit; (5) non-financial factors causing and exaggerating financial hardships; and (6) certain recent developments affecting the demand and supply of funds.

I. Gaps In Industrial Finance

The chief function of credit is to enable the borrower to start and conduct his business in the best possible way (also see the previous chapter). In order that this may be achieved, the private financial system is expected to provide the following types of capital which different industries require in different proportions: equity capital or ownership investment, loans (medium and long-term debt to supplement permanent share capital if shares are issued), and short-term or commercial credit. The following analysis will furnish some idea as to how far these requirements of Indian industries are being met by the private financial organisation.

Breadth of the Money and Capital Markets—Private agencies that have so long been catering to the requirements of industrial finance in India are:—(1) the managing agents and other private firms, including insurance companies; (2) joint stock banks; (3) indigenous bankers and money-lenders; (4) public deposits; (5) co-operative banks and producers' societies; and (6) local banks and loan offices. Of these the managing agents, local banks and loan offices are chiefly agencies for medium-to-long-term finance, whereas the commercial banks, indigenous bankers and money-lenders, co-operative institutions, and the system of public deposits are usually agencies of short-term credit, although with the single exception of

public deposits, all the above agencies are known to have supplied funds for both long and short-term purposes. The managing agency system has its exact counterpart nowhere in the world. As regards the various types of industries financed by these various institutions, this can be said with fairness to all the parties concerned that the systems of managing agents, commercial banks, public deposits, local banks and loan offices have mainly concentrated on organised large-scale and middle-sized industries, while indigenous bankers and money-lenders, co-operative banks and producers' societies combine to form an apparatus which serves principally the needs of small and cottage enterprises which, in their turn, account for the major portion of industrial activity in India.

Pre-war expert views were unanimous on one serious gap in the financial organisation, namely, the virtual absence of organised machinery to under-write industrial shares and securities or otherwise assist an industrial company in floating its shares and debentures. The investing public, in most cases unjustifiably stigmatised as being unduly "shy", had also really no institution to guide them in their investments. The impact of the depression was such that on the eve of World War II the capital issue market lay in a state of virtual collapse. Of course, the subsequent years have witnessed the growth of a new capital issue market in India where the work of issue and underwriting has been mainly done, not by managing agents who were on the decline already before the War, but by issue and finance houses, investment companies and trusts, established in important commercial centres, as well as by firms of stock-brokers

and insurance companies, particularly in sub-underwriting. But still to-day "there is a relative absence in the Indian capital market of promoting, issuing and underwriting agencies."

There is a virtual absence of institutions specialising in marketing finance. Of course, fundamentally, it is the undeveloped character of an effective bill market that constitutes the most serious single impediment to marketing finance in India. In the sphere of foreign trade financing, the much-discussed lack of a sufficient number of Indian institutions still persists, and the business is even to-day practically a monopoly of European foreign exchange banks whose treatment to Indian businessmen has all along been condemned without exception.

So far as the degree of inter-relation between the various segments of the financial system is concerned, India, like other backward economies of Asia, has a sad story to tell. The link between the system of indigenous bankers and money-lenders and that of organised banking is so slender and ill-defined that even to-day a Bazar Rate of Interest as distinct from the Bank Rate exists. This mutual independence of these two sections has prevented the money and capital markets from acting as one single integrated unit. The outcome has been two parallel and virtually independent systems of money and capital rates, considerable disparity between urban and rural credit conditions, continuance of the old seasonal credit stringency, indicated by the undue margin between busy and slack season rates even after two decades of Reserve Bank participation in the money market, and

failure of low interest rates to be effective over the major part of the financial system during the era of cheap money.

Moreover, the institutional distribution between town and country is gravely unbalanced. Managing agency finance has not been extended to rural industries. Rural areas are still starved of commercial banking facilities. The industrial financing organisation of the rural areas is quite under-developed. As for towns, joint-stock banking is yet to extend to many. Thus, not only does a vast difference exist between urban and rural credit facilities to the detriment of small business units all over the countryside, but noticeable disparities also continue between urban areas themselves much against the interests of firms in the smaller towns.

To this has been added a serious mal-distribution of financing agencies between the different States of the Union. The public deposit system is important only in the Bombay-Ahmedabad region. Loan offices are the specialities of Bengal and Assam. Commercial bank deposits obtained in one State are not usually utilised for investment in another, and Bombay, Madras, U.P. and W. Bengal between them share about 80 p.c. of total scheduled bank advances. The managing agency houses are mostly quartered in either Bombay or W. Bengal. Of these two States again, Bombay appears to have been the more fortunate, for it has been claimed that most of W. Bengal's medium-scale industries have not been financed by the agency houses¹. Even large-scale industry

¹ Dr. Law's letter to the Secretary, Industrial Finance Sub-Committee of the National Planning Committee, vide Report (1948), p. 179.

has not altogether escaped the harmful effects of this regional mal-distribution. It was pointed out, as early as 1935, that possibly the relative scarcity of funds in Ahmedabad *vis-a-vis* Bombay had compelled the cotton mills there to be content with a smaller size than in Bombay.²

Adequacy of Resources—The inadequacy of total resources possessed by the managing agency system has been voiced both before and after World War II.³ The insufficiency of total banking resources was exposed through the complaints of several bankers before the Indian Central Banking Enquiry Committee in the early 'thirties, and it has again been touched upon in post-war studies⁴. The indigenous shroffs and money-lenders possess very limited funds. The capital pool of the industrial co-operative system is not imposing enough relatively to the size of demand. The plight of Indian enterprise is easily understandable. As the Shroff Committee observes, "...the existing financial institutions can go only a part of the way in meeting the requirements of industrial finance."

Adequacy of Total Assistance given—No better testimony to the inadequacy of total assistance forthcoming from the managing agency system is to be found than the increasing complaints of the agents themselves about the financial plight of concerns under them and

² P. S. Lokanathan, "Industrial Organisation in India" (1935), p. 96.

³ Lokanathan, *op. cit.*, p. 150, and S. K. Basu, "Industrial Finance in India" (1950 ed.), p. 186.

⁴ Interim Report of the Industrial Finance Sub-Committee of the N.P.C., p. 74 ; Report (1951) of the W. Bengal State Financial Corporation Committee, p. 27.

their frequent appeals for State aid in recent years. The size of commercial banking assistance—before, during and after World War II—has been subjected to severe adverse criticism by expert opinion in India. True, the desirability or otherwise of these banks' participation in capital financing in our under-developed economy is still a moot issue. But the fact remains that the commercial banking system has, on the whole, taken a relatively small part in long and medium-term industrial financing. Nor has its role in providing current finance been entirely satisfactory.⁵ The organisation of indigenous bankers and money-lenders has failed to supply all the requirements of small businesses. The system of public deposits as a source of short-term finance in Bombay worked satisfactorily in pre-Depression years.⁶ But since the Depression this source has been drying up due to investor nervousness coupled with the counter-attraction of Government securities. Its adequacy is now questionable. There can be no two opinions regarding the insufficient volume of aid available from the co-operatives. The loan offices of Bengal and Assam, mainly financiers of the tea estates, ever since they were 'trounced' by the Depression, have gradually receded into the back-ground. This inadequacy of total funds available from the private financial organisation has been chiefly responsible for the chronic under-capitalisation of industries, including the larger ones, noticed long before World War II and lingering even in our times.

⁵ See Lokanathan, *op. cit.*; the Indian Fiscal Commission Report (1960), Vol. I.

⁶ S. K. Basu, *op. cit.*

Interest and other Costs—There is an impressive agreement on the point that finance could in the past, and still can, be attracted only at relatively high rates of interest. In course of investigations of the Indian Central Banking Enquiry Committee during 1929-30, entrepreneurs repeatedly asserted that interest rates on bank loans and advances were too high. Many bankers admitted that their advance rates varied from 10% to 15% even on the security of mortgage bonds. Rates on bank loans to small industries for working capital varied between 9-12%—between 15-18% in Bengal—before 1939.⁷ High rates charged by managing agents for operational finance had also been alleged.⁸ Pre-war rates on public deposits were also fairly high except for big established firms under renowned managing agents.⁹ Some Bengal and Assam industries had to pay 15-36% for working capital from money-lenders.¹⁰ In Bombay, money-lenders' rate for artisans varied from 9% to 18%, 12% being usual.¹¹

Now to come to the post-war period. The Co-operative Planning Committee of the Government of India has mentioned the 'high' rates on small loans.¹² The Industrial Finance Sub-Committee of the National Planning Committee in its Interim Report has pointed out that while some artisans may borrow at 12-18%, others can borrow only at 18-30%. The same Committee has referred to high rates on aid to middle-sized concerns.

⁷ Samant and Mulky, "Organisation and Finance of Industries in India" (1937), p. 230.

⁸ *Ibid.*, p. 130. ⁹ *Ibid.*, p. 126. ¹⁰ *Ibid.*, p. 132.

¹¹ Report (Vol. I) of the Bombay Economic & Industrial Survey Committee.

¹² *Vide Report* (1946), ch. x.

High rates of private agencies financing rural industries have been alleged in the All India Rural Credit Survey.¹³ Film producers of Madras, in their evidence before the Government of India's Film Enquiry Committee in 1950, had stated that even established producers had been forced to get loans at anything from 25% to 40%.¹⁴ Interest rates for commercial bank advances have varied between 6% and 9%, those charged by private financiers between 6% and 30% in West Bengal.¹⁵ Interest rates on loans from co-operative agencies are also fairly high. A study of long-term rates in the immediate Post-war period reveals that the average rate on 242 issues of Preference shares of important organised industries is nearly 6.1% (variation 3-10%), and that the same rate on 105 issues of debentures of the same industries is 5.5% (variation 2½-8%).¹⁶ As against this state of affairs in India, capital rates in the U.S.A. varied from 2% to 3% during 1944-47.¹⁷

We find that high interest costs have characterised finance for private industry in India. Yet interest costs do not give a full picture of things. In return for his help, the middle-man-cum-money-lender demands the purchase of raw materials and the sale of finished goods through him, at prices fixed by him, and this eats heavily into the income of the small enterprise. High remunerations charged by managing agents have been an oft-

¹³ *I*vide the General Report (1954).

¹⁴ See Capital, Aug. 17, 1950, p. 266.

¹⁵ W. Bengal State Financial Corporation Committee Report, pp. 16-17.

¹⁶ Mulky, "The New Capital Issue Market in India" (1947), ch. v.

¹⁷ Burtchett & Hicks, "Corporation Finance" (1948), p. 514.

repeated complaint. Though according to one suggestion,¹⁸ the over-all cost of making issue does not compare unfavourably with that in the London Capital Market, its fairness is yet far from established.

Some Non-Financial Complications—It would, however, be a travesty of truth to say that the unsatisfactory work of the private financial mechanism is due entirely to its own faults. High risks and poor management of small enterprises, reflected in frequent failures of such businesses, have always reduced their credit-worthiness. Defective management of large-scale industries by managing agents (contributing to a preference for Government paper on the part of investors) has also been alleged in both pre-war and post-war studies.¹⁹

Some Recent Developments—The following factors have in recent years favourably affected the supply position :—(1) enormous war-time and post-war growth of branch banking and tremendous rise in bank advances; (2) post-war tendency amongst a section of commercial banks to participate in long-term financing; (3) growing strength and importance of the co-operative credit system; (4) rise in national money income; (5) the creation of the Industrial Credit and Investment Co-operation; (6) the policy of low money and capital rates

¹⁸ Mulky, *op. cit.*, ch. v.

¹⁹ N. G. Das, "Industrial Enterprise in India" (1938), p. 145 ; and "Industrial Planning : Why and How" (1944), p. 47 ; Lokanathan, *op. cit.*, p. 145 ; Report of the N.P.C. Industrial Finance Sub-Committee, p. 151, p. 155 ; Report (1954) of the Committee on Finance for the Private Sector, p. 25.

followed till November 1951; and (7) the growth of well-managed stock exchanges.*

But forces have also come into operation which, by increasing demand or restricting supply, have tended to widen the financial gaps. Some of them are:—(1) the alleged decline of profits and consequent difficulty in financing expansion and modernisation; (2) growing rigidity of credit legislation deterring banks from long-term financing; (3) restriction of credit in the private sector owing to money-lending legislation; (4) ineffectiveness of cheap money over the bulk of the financial organisation; (5) end of cheap money policy in November, 1951; (6) scarcity of long-term risk capital owing to the stagnation in the capital issue market (the stagnation still prevailing, though in a less acute form since 1953, October); (7) the Insurance Amendment Act, 1950, restricting assistance by insurance companies to small and medium industries; (8) continual heavy withdrawal of money from the Indian banking structure and its flight abroad, especially to the U.S.A., alleged to have been caused by the Government's attitude towards tax evaders and high yields on foreign investment²⁰; (9) an "unfavourable socio-economic climate"; (10) diminishing flow of savings into the organised capital market caused by factors affecting adversely the will and the capacity of the private investor to invest; (11) a gradual drying-up of investment funds for relatively small business due partly to investor preference for the gilt-edged and

* The establishment of a bill market in January, 1952, through the efforts of the Reserve Bank of India, may also be considered in this connection.

²⁰ The Statesman (Cal.), April 11, 1951, p. 7.

securities of the big-name companies ; (12) increasing competition from the governments and governmental agencies for the very small surplus of total national savings available for investment ; and (13) the huge requirements of financing the expansion, modernisation, and rationalisation of industries. .

Whether the final outcome has been a positive widening or narrowing of the financial gaps is not so easy to determine. Nevertheless, the current situation is capable of being summarised in the following words. It appears that so far as long-term risk and loan capital is concerned, "all classes of industries . . . are experiencing difficulties, except perhaps the leading companies which are able to raise moderate amounts of such finance." "As regards working capital it seems that large-scale industries, in general, do not suffer from any shortage, but the problem is acute for medium-scale and small-scale industries." The growing and greatest menace to small and cottage industries is the problem of short-term working capital, block capital being a very small part of such industries' requirements. New firms in every industry have to suffer most because they inevitably have to face certain special handicaps.

II. Gaps in Agricultural Finance*

Breadth of the Money and Capital Markets—The existing private agencies of agrarian finance are:—(1) the co-operatives, (2) relatives, (3) landlords, (4) agriculturist money-lenders and professional money-lenders, (5) traders and commission agents and (6) commercial

* The interested reader may consult the General Report (1954) on the All India Rural Credit Survey for details.

banks. We may also mention the loan offices in West Bengal, Nidhis and Chit funds of Madras, some industries consuming cash crops as raw materials, and the indigenous bankers. Most of these agencies do not maintain a strict separation of all the three types of farm credit requirements—short, intermediate and long-term. Money-lenders supply production, marketing as well as consumption finance for various periods. Indigenous bankers finance, for the most part, indirectly through local money-lenders, and furnish mainly short and medium-term funds for marketing purposes. Amongst co-operatives, land mortgage banks furnish long and medium-term finance, whilst co-operative credit societies supply both short and medium-term funds, although they specialise in short-term financing. Commercial banks generally do not provide long or medium-term finance; even in short-term business they usually confine to marketing as distinct from production finance, which they supply mostly indirectly, although a few of these banks did, and are still doing, the long-term lending business and are increasingly participating in direct farm financing. Like money-lenders, relatives and landlords furnish aid for different durations. The Nidhis and Chit funds of Madras are sources of short and intermediate-term credit for their members. Among the industries financing agriculture the jute industry is worthy of mention. It has been pointed out that it is scarcely realised how the movement of jute from the jute districts to the consuming centre in Calcutta is heavily financed by money supplied by the jute mills.²¹ Thus, India possesses

²¹ *Capital*, June 2, 1949, p. 907.

a variety of private agricultural credit agencies. An agricultural bill market to facilitate marketing finance is yet to develop.

These various credit agencies are mostly ill-coordinated. They act "as disjointed units rather than as parts of a single, well-organised and integrated money market." There is little connection between the village money-lender and joint-stock banks; the link between the latter and indigenous bankers is extremely loose and ill-defined; nor is there any appreciable co-ordination between co-operative and commercial banking. As in the case of industrial finance, there really exist two mutually independent markets for agricultural finance—the organised and the unorganised.

Upon this structural maladjustment has been superimposed a regional maldistribution of financing institutions as in industrial finance. We have already noticed how there exist serious disparities of available banking facilities between town and country as well as between different States. Many areas have hardly any rural credit facilities at all, good or bad or indifferent. Co-operative societies and central banks are not uniformly developed throughout India. Only Madras, and to some extent, Bombay can boast of successful land-mortgage banking.

The consequences of this disorganised character of the rural credit market have been reflected in a lack of relationship between interest rates charged by the two separate sectors, unwarranted fluctuations and divergencies in interest rate, forms of security, methods of payment, collection and realisation of funds between

States as well as between urban and rural areas (particularly intensifying the difficulties of specially handicapped regions and classes), unjustifiable spread between busy and slack season rates, and finally, restriction of the effects of the Reserve Bank's low interest policy to the small organised sector, benefiting the bulk of rural finance very little, if at all.

Adequacy of Loanable Funds of Private Agencies—

Total resources of private institutions are quite insignificant relative to the requirements of the agricultural community in India. We think, this proposition is beyond controversy.

Adequacy of Actual Assistance Rendered—The total annual borrowings of Indian cultivators have been very broadly estimated by the All India Rural Credit Survey to be of the order of Rs. 750 crores. Of this sum, nearly 96% is supplied by private agencies, including co-operatives. For a vast country like India, this is a rather unsatisfactory figure. 1% represents the part played by commercial banks in the direct financing of the riot.²² "Nor are commercial banks of any significance as lenders to co-operative banks or co-operative marketing societies." Advances to agriculture by these banks as percentage to total advances come up to 4·3%.²³

The co-operatives account for not more than 3·1% of the total amount borrowed by the cultivator. The inadequacy of the finance available from co-operative agencies warrants "only one judgment, namely, 'failure', on the fifty-year record of the co-operative credit

²² *Vide* the All-India Rural Credit Survey, Vol. II (1954).

²³ The Shroff Com. Report (1954), p. 44.

agency," according to the All India Rural Credit Survey (General Report, 1954). The Report (1945) of the Agricultural Finance Sub-Committee of the Govt. of India's Policy Committee on Agriculture, also known as the Gadgil Committee, estimated that just about 5% of the rural population had been touched by co-operative credit.

"The private money-lender thus dominates the scene, the professional money-lender with about 45 p. c., and the agriculturist money-lender with nearly 25 p. c., of the total." But has the credit granted by this system been less than adequate, or more than adequate? Though our analysis points to a cent per cent possibility of under-financing*, the opinion has been voiced from time to time that the money-lender has been, not unoften, lending "too liberally."

"Over-financing" by co-operative agencies was also alleged some time ago.²⁴ And serious still, a general thesis of over-financing by the agricultural credit mechanism as a whole has been propounded, in terms of which the inability of any one agency to satisfy all the needs of the agriculturist, the resultant recourse by the agriculturist to more than one agency for credit, and the impossibility for any one of these to know exactly the amounts lent by others inevitably lead to over-financing.²⁵ Another alleged cause of over-extension of farm credit is the ability of the riot to borrow in excess

* The Gorwala Committee which conducted the All India Rural Credit Survey appears to agree with our view.

²⁴ Ghose, "Problems of Agricultural Credit in India" (1937).

²⁵ Deshai, "The Rural Economy of Gujarat" (1948). pp. 182-3.

of what is justified by the return on land.²⁶ But the thesis is defective on the following grounds:—(1) The charge of excessive farm indebtedness—the real basis of the thesis—is a flat contradiction of the fact that the average Indian farmer cannot secure enough finance to operate his farm in the optimum way. For credit represents indebtedness. (2) The case of the excessive indebtedness theorists really rests on two arguments:—(a) the riot can borrow in excess of his repaying capacity, and (b) the bulk of the debt has been wasted on unproductive items. But the ideal criterion for granting credit in a poor under-developed economy is more the need of the riot, and less his repaying capacity. The answer to the second argument is contained in the following remark of the Congress Agrarian Reforms Committee, “Though it is generally made out that the debts are mostly of an unproductive character, the statistical data compiled by us, though inadequate, prove to a great extent that the bulk of the peasantry incur debts mostly for expenses in connection with cultivation.”²⁷

The thesis of ‘over-financing’ is a myth. What we want or should want, therefore, is no cut in total rural indebtedness, paradoxically enough, but rather its increase coupled with a change in the source and cost of its creation, so that, instead of being a burden on activity, it becomes a very condition of efficient farming in India.

²⁶ Article by N. Prasad, *Indian Journal of Commerce*, Sept., 1948.

²⁷ *Vide Report (1949)*, p. 104.

Interest and other Costs of Credit—The Congress Agrarian Reforms Committee (reporting in 1949) has found that the rate charged by the money-lender is generally 15-30% though 50% has also been charged at places and times. According to the All India Rural Credit Survey, interest rates of 50% or above are not infrequent in certain areas. The money-lender's rate is really high.

The charge of high rates demanded by co-operative societies does not look wholly baseless. Primary credit societies have been charging the following rates from their members in different parts of the country: 7½% in Madras, 9¾% in Bombay, 9¾%, 12½% and 15¾% in Bihar, 12½% in W. Bengal, 8% in Orissa, 9% in U. P., 2—12½% in the Punjab, 7% in Madhya Pradesh and 12½% in Assam. Nor the land mortgage bank rates considered moderate.

Costs of credit other than interest-costs also have been proverbially high, especially in the field of money-lenders' finance, and the sequel has been the continuance of an undue margin between the price paid by the ultimate consumer and that received by the primary producer.

If we put aside the small percentage of big land-holders who are certainly better off now than in 1939, the conclusion is inescapable that the present rural credit structure is not equipped to meet even the short-term needs of agriculture, not to mention its intermediate and long-term needs. It seems, however, that the small unit of production in agriculture fares better than its counterpart in industry in so far as the availability of finance from private agencies is concerned.

III. Remarks

It cannot be definitely stated whether the private-financial mechanism to-day is better equipped to meet the needs of private enterprise than at any previous time. For whilst due to several developments during the war and post-war years the supply of investable funds has registered improvement, the demand for funds has also at the same time gone up. This much can be said that whatever the effects produced by the war-time and post-war developments in industrial and agricultural finance, wide and serious gaps still linger within our private financial system, and that there are no signs to indicate that these gaps are going to be closed within a reasonable period of time by the system's own efforts. Unless, therefore, these gaps are filled up by the State creating its own financing machinery to work in close unison with, and as a supplement to, the private financial system, a large part of desirable investment in the private sector of business may be held up for lack of money, eventually jeopardising the objective of greater employment and larger output.

CHAPTER III

FINANCING INDUSTRY

A. Features of the System as a Whole

Notwithstanding the strong tradition of *laissez faire* of the Govt. of India during the British rule, the evolution of a definite governmental policy of financial assistance to private industry is by no means a recent, or as sometimes imagined, a post-Independence development. Whatever the ulterior political motive behind it, it is the 19th century system of government guarantee of interest on the share capital of private railroads that is one of the main factors making the Indian railway system what it is today. The appointment of the Industrial Commission in 1916, of the External Capital Committee in 1924, of the Central Banking Enquiry Committee in 1929, amply demonstrates the recognition given long ago by the Govt. of India to the role it was to play in the sphere of industrial financing. At the beginning of the 20th century, a few States could be found financing private industry in various ways, direct and indirect. The 'twenties witnessed the adoption of important measures by several States for facilitating private industries' finance with particular stress upon small-scale and cottage industries. One noticeable trend of public policy, particularly after the constitutional changes of 1919, was the gradual distribution of responsibility between the Centre and the States such that large organised enterprises become predominantly a concern of the Central Government, whilst the States concentrated upon

relatively smaller businesses. On the eve of World War II the Central Government and the Governments of the States (except a few small and backward ones with neither industry nor funds to help industry) were extending financial support to private industry in the following ways:

(i) In the case of the Govt. of India—direct financing by appropriate departments in the shape of loans, grants and subsidies, guarantees, subscription to shares and debentures; indirect aid through tax concessions, provision of technical advice, commercial and industrial intelligence, research facilities and various other technological services which went, somehow or other, to improve management and reduce risks and other costs of private investment, periodical re-adjustment of tariff, transport concessions, a favourable stores purchase policy, and certain measures to create and extend markets for certain products, those of cottage industries in particular.

(ii) In the case of the States—direct departmental aid in the form of loans, grants and subsidies, participation in shares and debentures, guarantee of minimum returns on such shares and debentures, and underwriting (though rarely) private share issues; indirect aid by means of various technological services to industry partly or wholly at public expense, and in addition, direct financing by special public agencies in a few States like Bengal (undivided), U. P., Travancore and Hyderabad. Both the Centre and the States displayed special interest in fostering industrial co-operation. Although most of the methods of aid were common to

both the Centre and the States, the former seemed to have specialised in indirect assistance, leaving the latter to devote major attention to direct financing. One special feature of pre-war public assistance was the virtual absence of what might be called the institutional approach. Except in the aforementioned States, State aid used to be channelled, not through specialised financing agencies, but through relevant government departments. There was no all-India specialist body.

How far this structure of State aid underwent significant changes during World War II has never been precisely known. It is understood that the only new item of importance, included during the war-time, was the system of progress payments on government contracts (as in the U. K. and the U. S. A.)* which, however, was discontinued after the war. The continuous pursuit of a cheap money policy uptill 1951 November has been the most spectacular means whereby the State has indirectly eased the job of securing investment funds by private industry. On the whole, however, it appears that the mechanism of State assistance at the beginning of the war was not significantly different from that at its end. U.K. United Kingdom

The Industrial Policy Statement of the Government of India, issued in April 1945, envisaged financial aid of the following types:—loans and subscriptions to share capital, guaranteeing minimum dividends on capital or undertaking to meet revenue losses for stipulated periods, facilitating research work, standard-

USA. United States of

* Basu S. K., "Industrial Credit in War and Post-war Economy" (1945), ch. vii-ix.

ising products, procuring capital goods from abroad and making expert advice available. These proposed methods were *prima facie* nothing new. The newness, if any, consisted in the assurance that State aid would henceforward be available more liberally than hitherto. The contents of State aid so far given were pathetically void of substance and really far below the level of sufficiency. In practice, government policy had been pursued half-heartedly, haphazardly, and inadequately.

The new policy could not be carried out owing chiefly to the end-of-war political situation with uncertainty written upon everything. It was left to the Government of an independent India to formulate a policy which would be nearer to national aspirations, nearer to consistency and adequacy, and more upon a planned basis than any followed before. The Industrial Policy Statement of the Government of India, issued on April 6, 1948, inaugurated a new era. The status and sphere of private enterprise were recognised and clearly defined, and the necessity of meeting a large part of its financing programmes was acknowledged. On April 1, 1951, the people of India started to build a better life according to the First Five Year Plan, and this Plan endorsed the policy decision of April, 1948. In the Plan provision was made for giving financial assistance to private industry by way of loans from the Government and from Industrial Finance Corporations to the extent of about Rs. 25 crores, and by way of refunds of excess profits tax deposits of the order of Rs. 60 crores.¹ The difference between pre-Independence

¹ The First Five Year Plan (1952), pp. 486-7.

and post-Independence policies is both quantitative and qualitative. The quantitative difference has consisted in a larger utilisation of the old methods of aid by departments, involving more loans, more grants and subsidies, more participations in capital, more tax concessions†, larger expenditures on technological aid, and so on. The qualitative change has assumed the form of new, specialised institutions to cater chiefly to the long and intermediate-term needs of private industry. In 1948, the Government of India set up the Industrial Finance Corporation on an all-India basis to finance large-scale industry, while the States were empowered by the State Financial Corporations Act of 1951 to set up (and a few now actually possess) their own special corporations to support small, local industries. In 1954 October, the National Industrial Development Corporation was created by the Government of India. It is wholly owned by the State. It would not only develop industries on its own account but also finance, if necessary, vital private industries. In January 1955, the Industrial Credit and Investment Corporation was registered. It is an exclusively private agency, but it has been provided with a long-term loan of Rs. 7½ crores by the Central Government. It would both develop and finance private industry. These two new agencies would support large industries on an all-India basis. Recently (in 1955) the West Bengal Government has established a Development Corporation for developing small industries within W. Bengal. Following the recommendations of the Inter-

† The necessity of a favourable tax policy for private industry has been strongly emphasised by the Union Government's Taxation Enquiry Commission.

national Planning Team, sponsored by the Ford Foundation of the U. S. A., the Union Government has recently floated a National Small Industries Corporation with an initial capital of Rs. 10 lakhs, provided wholly by the Union Government, to promote small enterprises, run by public or private authorities. The Corporation will furnish financial as well as technical and managerial assistance, and try to bring about co-ordination between large and small industries. It is free to act as managers for any company or enter into partnership with it. It will promote and operate small industrial development schemes.* The creation of this Corporation amply demonstrates the truth that in an economy geared to long-term development planning but politically organised on a federal basis, the Central Government is bound to be ultimately responsible for the balanced and co-ordinated development of all sorts of industries throughout the system. But there is an over-all trend towards a division of functions between the States and the Union (the Union financing mainly large industries and the States mainly smaller businesses), and this is, as we have already noticed, a heritage of the inter-war period. This trend was not, of course, very much prominent in pre-war days, as in those days the over-all emphasis in the matter of financial assistance fell upon small industries. Several special Boards have been created to render mostly technical assistance to certain industries, e.g., the All-India Handicrafts Board, the Central Silk Board, the Central Tea Board, and so on. Another qualitative change has been the adoption of a policy of special

* Source: *The Statesman* (Cal), April 25, 1955.

measures for certain sectors like shipping, housing, aviation, veterans' affairs and refugee rehabilitation.

A notable gap in the structure of State aid to-day is the non-availability of government funds for use in the direct financing of private foreign trade. Special public financial agencies to help foreign trade exist in several foreign countries, e.g., the Export-Import Bank in the U. S. A., the Export Finance Corporation in Japan, the Export Finance Corporation in Holland, the Export Credits Guarantee Department in the U. K., and the Export Credits Insurance Corporation in Canada. Leaving this aside, it can be inferred that State aid has by now touched all important lines of private industrial activity, although a good deal still remains to be done before it can become satisfactory or sufficient. The major part of this assistance will be examined in details in subsequent chapters. What immediately follows is a discussion of over-all direct financing by the Central Government Departments.

B. DIRECT FINANCING BY CENTRAL GOVERNMENT

Some Important Post-war Loans—The Government of India has made loans of Rs. 3·5 crores to the Steel Corporation of Bengal and Rs. 1·5 crores to the Indian Iron and Steel Company, Rs. 2 crores to the Tata Locomotives, Rs. 1·5 crores to the Scindhia Ship-building Yard, Rs. 2 crores to the Mysore Iron and Steel Works, Rs. 10 crores to the Tata Iron and Steel Company and Rs. 3 crores to the Atul Dyestuff Corporation.² All these

² This loan is a very recent one. Source: *Statesman*, Dec. 23, 1954, p. 9.

are long-term interest-bearing loans given direct by the Government to the borrowers. Besides, the Central Government has direct responsibility for small industries in the Centrally Administered Areas, to fulfil which it has established, by non-statutory regulations, Advisory Boards for all such Areas except the Andamans.

Share Participation—In so far as this is concerned, Central policy has consisted in taking shares of large-scale industries usually upto 51%, with a few important exceptions, e.g. in the case of the shipping industry where larger percentages have been contributed.

Subsidies—Apart from the liberal subsidies to the air and shipping industries which would be discussed in the next chapter, the most important general subsidy has been that given to the aluminium industry which has been aided chiefly by the device of subsidy-cum-protection. Subsidies are also being given for promoting industrial housing schemes. The subsidy-rate for the aluminium industry has been as follows³ :—

| Yr. | Commodity | Indian Aluminium Co. Rs. | Aluminium Corporation of India Rs. |
|---------|------------------|-----------------------------------|---|
| 1949-50 | Sheets & Circles | 380 | 710 |
| | Ingots | — | 900 |
| 1950-51 | Sheets & Circles | 230 | 610 |
| | Ingots | — | 825 |
| 1951-52 | Sheets & Circles | 130 | 510 |
| | Ingots | — | 750 |

Guarantees—The most important guarantee of recent years is the one given to the tea industry during the

³ Government of India, Ministry of Commerce & Industry, Letter No. IP—4725/51, dated 15-6-1951, and *Statesman*, April 26, 1951.

critical 1952-53. In view of the financial difficulties experienced by tea gardens during the 1952-53 season, a limited guarantee scheme was worked out by the Central Government in consultation with the Reserve Bank of India. The Government undertook to give a partial guarantee to scheduled banks and apex co-operative banks which would continue to grant normal advances to tea gardens in the 1953-54 season. The guarantee was limited to 20% of the repayments made by the gardens in their hypothecation accounts with banks for the 1952-53 season in the case of gardens situated in Cachar and W. Bengal, and 15% in the case of gardens in other areas. However, with the improvement of tea prices in 1953-54, there was little need for banks to take the help of the scheme.†

The following figures will provide an idea of assistance given in recent years by the Central Government :—

| <i>In lakhs of Rupees</i> | | | |
|----------------------------|------------|---------|---------|
| | 1951-52 | 1952-53 | 1953-54 |
| | (Accounts) | (R. E.) | (B. E.) |
| (1) Share participation .. | — | 25 | 108. |
| (2) Loans .. | 310 (R.E.) | 274 | 827. |
| (3) Grants .. | 90 | 17 | 9 |
| | 400 | 316 | 944 |

Notes : (1) Includes investments in Hindusthan Shipyard, Eastern Shipping Corp., Machinery Manufacturing Corp., etc.

(2) Includes loans to iron and steel companies, shipping companies, etc.

† Reserve Bank of India Bulletin, August 1954.

(3) Includes grants to Central Silk Board, Soda Ash industry, Aluminium industry, etc.*

Guarantees have been given in exceptional cases. The subsidies seem to have been liberally granted. The loan figures, by themselves, certainly look impressive. But in contrast to the size of the total demand of the borrowing industries, they are too small indeed. In the era of planning, however, total aid given to private industry has been on the increase.

Much can be said in criticism of the existing system of direct departmental aid. We leave the discussion of this topic for a later chapter, only stressing here that special financing authorities in the form of Boards or Corporations (on the lines of the Iron and Steel Corporation of South Africa) could be created to deal exclusively with such huge industries (e.g. iron and steel, and shipping) as cannot be fully accommodated by the existing I.F.C. of India and the I.C.I.C. The concept of specialist public agencies for exclusively financing specific private industries is not entirely new in India. The Report (1951) of the Film Enquiry Committee of the Government of India recommended the creation of a Film Finance Corporation on the analogy of a similar Corporation in Great Britain. The special character of the requirements, costs and risks of several big, important industries call for special arrangements for their financing. But a better alternative would be the creation of special departments at the I.F.C. of India and the National Industrial Development Corporation to finance

* Source : Report of the Committee on Finance for the Private Sector (1954), p. 142.

only specified enterprises. Such departments would not be wholly without parallel. In 1939, the Industrial Bank of Venezuela, of which the State is a 60% shareholder, undertook to make regular contributions to form a "Special Account" in order to supply credit to businesses unable to secure funds from existing private sources or even from the Bank's regular departments.⁴ But there must be thorough co-ordination between such a department and the institution as a whole, between the different specialist Corporations working on an all-India basis, and between such Corporations, on the one hand, and the Central Government Departments, on the other.

⁴ U.N., "Economic Development in Selected Countries", Vol. I (1947).

CHAPTER IV

FINANCING IN SPECIFIC SPHERES

In the previous chapter we have pointed out how the policy of evolving special measures to assist private effort in certain spheres like shipping, housing, and several others has been emphasised by the State in India in the post-war years. There are good reasons for such a policy. First, the problems involved in the financing of such enterprises are largely unique in character, and as such, do not coincide wholly with those of business financing in general. Secondly, of these enterprises some are so big in their size and/or relative importance that specialisation in their financing is economical or otherwise desirable. Finally, the specialised agencies like the I.F.C. of India and the State Financial Corporations have been excluded by legislation from the task of accommodating such enterprises. (Of course, by virtue of an amendment of the I.F.C. Act in 1952, the I.F.C. can assist shipping concerns. But as yet† financial help has not been extended by the I.F.C. to the shipping industry.) Under the circumstances, the only way open to the Government has been to contrive special measures for promoting those enterprises whose interests cannot safely be overlooked by any State in the modern world.

I. Shipping

The beginning of a dynamic approach to the whole question of shipping finance is really a post-Independence phenomenon. As early as 1923, the Mercantile Marine

† Uptill 1953-54.

Committee of the Government of India had recommended bounties to private shipping. But state action in this respect was nil until 1947. This was not unnatural for a Government controlled by a foreign maritime power. The consequence has been that the Indian shipping industry to-day is only the embryo of what it might have been.

At present the Government of India assists private shipping by means of various technical services, loans and subsidies, and contributions to share capital. It is very difficult to say exactly when the loan-plus-subsidy system had come into operation. According to information supplied by the Director-General of Shipping, no financial help by way of loans or subsidies was given as late as July, 1951. * According to another source of information, the Government of India had, by May, 1951, lent Rs. 1½ crores to the Scindhia Shipbuilding Yard.¹ A provision of Rs. 4 crores as loans to the shipping companies has been made in the First Five Year Plan. This would assist the shipping companies in replacing obsolete tonnage operating on the coast. The acquisition of additional tonnage for overseas trade would be facilitated by the provision of Rs. 6·5 crores as loans made in the Plan. By virtue of a Government decision taken in 1954, it is possible to secure such loans at the rather nominal rate of 2½%.²

According to the Central Ministry of Commerce and Industry, subsidies were given as early as 1950. In

* Office of the Director-General of Shipping, Letter No. 23—CD(6)/50 of 13-7-1951.

¹ Capital, May 10, 1951, p. 661.

² *Hindustan Standard*, 1954 Supplement, p.

February, 1950, this Ministry placed orders for the building of 3 cargo ships of 8000 tons each, on Government account, with the Scindhia Steam Navigation Co. Ltd. The total cost of the vessels was expected to be Rs. 193·5 lacs. They were to be sold at their market value of Rs. 126 lacs, and the difference was to be treated as a subsidy.³ In September, 1951, the Government announced a Rs. 80-lak subsidy to the Scindhias. The purpose was to uphold local enterprise against low-cost foreign competition.⁴ Later on, the Government subsidised sales of ships built by the Hindustan Shipyard Ltd., the amount of subsidy paid during 1952-53 being about Rs. 1 crore⁵.

Aid by way of capital participation has taken the shape of creating two types of agencies on a State-cum-private-ownership basis: Corporations to operate self-owned vessels in overseas services, and companies to undertake shipbuilding. The Eastern Shipping Corporation, an agency of the former type, was registered in March, 1950, with an initial capital of Rs. 2 crores. The major proportion (74%) of its shares is held by the Government of India and the balance by the Scindhias, who are also its managing agents.† The Hindustan Shipyard Co. Ltd., registered in January, 1952, is an agency of the latter type. The Company was to have an authorised capital of Rs. 10 crores and a paid-up capital of slightly over Rs. 3 crores. Unlike the Shipping Cor-

³ Ministry of Commerce & Industry, Memo No. IP—4725/51 of June 15, 1951.

⁴ *The Statesman* (Cal.), Feb. 14, 1952.

⁵ Reserve Bank's Annual Report on Currency & Finance, 1952-53, p. 27.

† Data supplied by the Director-General of Shipping, *op. cit.*

poration, it was to be wholly under Government management. Government interest in capital was fixed at two-thirds, the rest being allotted to the Scindhias.† The Company was to take over the assets, liabilities and business of the Scindhia's Shipyard at Vishakhapatnam.

The techniques of direct financial aid to private shipping practised in foreign countries have usually included various types of bounties, subsidies and subventions, long-term mortgage loans for ship construction, guarantees, creating joint shipping ventures, and financing through government or semi-government specialist financial institutions. Germany provides the classic example of what the State can do to foster private maritime enterprise through liberal financial aid. Great efforts were made in the German Empire of the late 19th century to build up a mercantile marine which might in course of time rival that of Great Britain, and the growth of private initiative was directly and indirectly encouraged by the State—directly by subsidies and bounties, indirectly by such devices as the reduction of port dues and heavy payments for the carriage of mails. The U.S., British and French subsidies are well-known and of long standing. After World War II, Japan, another country which has all along attempted to set afoot a strong maritime industry, has floated a special Corporation, namely, the Shipping Corporation, to tackle diverse problems of shipping. In Pakistan, the Industrial Development Corporation, a government agency, is entrusted with the task of promoting private shipping. In India, unless the Industrial Finance Corporation embarks on a programme

† *The Statesman* (Cal.), January 22, 1952.

of assistance to the shipping industry on a large scale, the case of a specialised ship-financing machinery would be worthy of consideration.

II. Veterans' Affairs

Following in the footsteps of advanced western countries, the State in India has recognised as its duty the task of facilitating the re-establishment of ex-service personnel in civilian life. Leaving aside the insignificant efforts of some State Governments to solve the economic problems of war veterans by such means as giving facilities of training in academic and technical institutions and making grants of land, implements, livestock, etc., the major financing has been done by such government organisations as the Post-war Services Reconstruction Fund Trusts, the Ex-Service Women's Welfare Fund and the Defence Services Rehabilitation Organisation.

During World War II, the Government of India constituted a Fund known as the Military Reconstruction Fund, which consisted of monthly contributions by the Government of India at the rate of Rs. 2 per month for each combatant and Re. 1 for each non-combatant with effect from April 1, 1942. Similar Funds were also created for the Royal Indian Navy and the Royal Indian Air Force. But on March 31, 1945, when the three Funds had collected

| | |
|---|--------------------------|
| | Rs. 9,35,24,000 (Army) |
| + | „ 13,31,000 (Navy) |
| + | „ 11,84,000 (Air Force), |

the Government of India amalgamated the 3 Funds and called the new Fund "the Post-War Services Reconstruction Fund." After deducting 20% of the Fund for a

Central reserve, the balance was divided amongst the various Provinces (now Part A States) and princely States, the share of each Province/State being proportional to its strength in the 3 services at the outbreak of the war plus the number of recruits provided by it from the start of the war upto January 1, 1945. Since November, 1945, these regional Funds have been administered by the Indian States through Trusts as desired by the Government of India.

The Government of India had laid down that the corpus of the Fund in each State (Part A) would be spent on the collective benefit of ex-service men (other than Indian Commissioned Officers) recruited during the war and their dependants, and that the entire Fund be exhausted within 25 to 30 years. The facilities available from such Funds have comprised :—

- (a) scholarships and stipends,
- (b) provision of amenity buildings, libraries, etc.,
- (c) special measures for the health of soldiers' families,
- (d) group schemes such as (i) co-operative workshops, (ii) co-operative buildings, (iii) purchase of agricultural implements, bullocks, etc., in connection with crop farming,
- (e) special technical training facilities, and
- (f) grants in connection with group schemes of rural housing for the benefit of, and to be undertaken by, demobilised men.*

* Source : "The U.P. Post-War Services Reconstruction Fund Trust and the Ex-Service Men" (1947), Sections 1, 2 & 5.

The Ex-Service Women's Welfare Fund is another government agency for helping veterans' affairs. It is operated through a Central Committee in Delli which works through the regional Committees set up in the States. The objects of the Fund are : (a) to enable ex-service women to complete courses of education and training, (b) to help ex-service women in distress, and (c) to assist ex-service women resettle in business or self-employing occupations by furnishing them with a small amount of working capital, raw materials, tools, etc.

The Defence Services Rehabilitation Organisation was set up by the Central Defence Ministry after the Partition to administer financial and other types of aid to displaced ex-servicemen from Pakistan.

In 1951 the Government prepared a scheme which would link the rehabilitation of demobilised personnel with the Grow More Food Campaign. A total of 2,26,000 acres of land in U.P., Madhya Bharat and Bhopal was earmarked for colonisation by ex-soldiers. Finance was to be supplied for much the larger part by the Central Government and the State Governments in the shape of loans and grants, and part of it was to come from the Post-War Services Reconstruction Fund Trusts.⁶

Fairly large sums have been disbursed through the machinery of the Fund Trusts. But the Ex-Service Women's Welfare Fund has all along suffered from financial stringency. In comparison with what is being done in some foreign countries, the structure of veteran financing in India indeed looks rather narrow in scope.

⁶ Eastern Economist, May 18, 1951, p. 806.

So far as we know, there is no arrangement for government guarantee or insurance of loans granted by non-government financing agencies to eligible veterans to enable them to purchase or build homes, buy farms or business property, as in the U.S.A. The structure is far less elaborate than in Canada where veteran financing is done by various devices like grants, allowances, pensions, long-term re-establishment credits, insurance and guarantee of private loans.⁷ In Canada, it is the Department of Veterans' Affairs (1944) which administers legislation concerning ex-service personnel, whereas in the U.S.A., this task is performed by the Veterans' Administration, a special agency. The Indian system comes nearer to the U.S. than to the Canadian one in that the major burden of financing has been borne by specialised government agencies than by government departments.

The system's work so far, though inadequate, is laudable. This inadequacy is really a consequence of budgetary stringency. One noticeable feature of State aid in India, as in Canada and to some extent in the U.S.A., is the stress upon resettlement in farming and small business.

III. Aviation

The formulation of a sincere and many-sided plan of financial aid to the aviation industry is as much a post-Independence phenomenon as the rapid growth of the industry itself. Post-war State aid to the industry, prior to its nationalisation in 1953, had chiefly assumed the following forms—guaranteed payments under air mail agreements (to the Air India and the Indian

⁷ "Canada 1949", Dept. of Trade & Commerce, Ottawa.

National Airways), rebates and subsidies, indemnification against losses, long-term loans at 4½%, participation in capital, and various technical services.⁸ But the financial weakness of nearly all private air-transport companies persisted in the face of continued State aid. This did not in any way suggest that Government action was extremely inadequate but rather that the lasting solution to the chronic financial problem of the sub-marginal units of this vital industry lay in nationalisation followed by thorough rationalisation.* The industry was taken over by the State in 1953. The story of State aid to private enterprise in the aviation industry at present evokes only a historical interest.

IV. Housing

There is no country in the world where the Government has not facilitated house-financing in some way or other. In India, private house building had received State aid long before World War II. Pre-war assistance chiefly took the form of helping co-operative house-building by the State Governments. A second form of assistance was to make long-term loans available to the peasant for erecting houses on his farm under the Land Improvement Loans Act, 1883 (cf. the provision for advancing home loans to farmers in Canada under the Farm Improvement Loans Act, 1944), and this was also done by the States. Further, some State Governments used to supply loans to their officers, for periods seldom

⁸ Source : Office of the Director-General of Civil Aviation, Memo. No. ATI/20-295 of Sept. 27, 1951, and the *Statesman*, Feb. 10, 1952.

* Author's opinion as expressed in his original thesis submitted in 1952.

exceeding 5 to 6 years, to enable them to own houses. But the volume of the aid variously given was too small relative to requirements. Nor was the job done in a planned or systematic way.

The war and the partition not only seriously accentuated the problems of construction in the face of increased demand for housing facilities, but introduced new difficulties requiring treatment on a special, emergency basis. The post-war organisation of State financing, accordingly, came to be divided into two parts : the first embracing the pre-war structure of normal-time aid with a few additions the most important one being the programme of industrial housing, and second comprising special measures to support house construction and purchase for and by such emergency-groups as the war veterans and refugees from Pakistan. The responsibility does not rest entirely on the State Governments. On the contrary, the larger burden is at present being carried by the Central Government. Viewed as a whole, the system has undergone a transformation both in size and character. More significant still, government policy has received a fundamental re-orientation since the Second World War in that the entire programme is now being implemented according to definite, planned targets, and not spasmodically as in the past.

Financing Co-operative Housing

The most important component of the structure of normal-time aid to private housing consists of the various measures by the State Governments to help co-operative housing. Apart from inter-State variations in terms and conditions, financial aid to co-operative

housing has generally assumed the forms of interest-bearing as well as interest-free loans, grants, subsidies, special tax-concessions and free technical guidance. Regional Housing Boards exist in several States of India, e.g., Bombay, U.P., Madhya Pradesh and Hyderabad, to facilitate the work of the co-operative house-construction societies (of course, they perform other more important tasks). In the First 5-year Plan provision has been made for the creation of a Central Housing Board (comparable with the Federal Housing Administration of the U.S.A.) to supervise and co-ordinate the activities of the Regional Boards according to certain general principles.⁹

In Bombay, co-operative housing societies constructing "standard type" tenements in the 5 major industrial towns get loans at 3% or ½% less than the government borrowing rate, whichever is higher, while societies building larger tenements get loans at ½% above the Bank Rate, provided the latter is not lower than the government borrowing rate. The maximum permissible loan in any individual case is Rs. 5000 per tenement in Bombay City and suburbs, and Rs. 4000 elsewhere. The maximum duration is 35 years. These societies cater chiefly to the needs of the middle classes. The Government finances, under a separate scheme, societies organised by the backward classes through interest-free loans, subsidies and free distribution of available public lands. There is a Co-operative Housing Finance Corporation in Bombay.¹⁰ In Madras, the Government assists

⁹ Source : Reserve Bank of India, "Co-operative Housing" (1950) and the "Review of the Co-operative Movement 1946-48" ; the First Five Year Plan, ch. xxxv.

¹⁰ "Co-operative Housing", and Eastern Economist, Feb. 9 and July 13, 1951.

co-operative housing societies, under a planned programme, with loans, not exceeding 20 years in duration, usually carrying a 3½% interest rate. In Mysore, such long-term loans have been advanced at different rates like 3½% and 5%. Housing co-operatives are assisted also by other State Governments, e.g., U.P. and the Punjab(I).¹¹ But with the exception of Bombay and Madras, the size of assistance given in other States has been as small and limited as the development of co-operative housing itself. And what has been the record of co-operative housing? In the words of the Planning Commission, "Co-operative housing societies have attempted, to a limited extent, to provide accommodation for middle and low-income groups." The Planning Commission have recommended large-scale lending by the Central Government to housing co-operatives at cheap rates through the State Governments. They have laid "special emphasis on co-operative housing societies not only because they can mobilise private capital, which otherwise would remain dormant, but because they open the way for aided self-help in the construction of houses which should be encouraged for reducing the cost as much as possible."

Techniques of aid to co-operative housing in India may be compared with those in some foreign countries. Notable examples of countries where Governments make long-dated loans to co-operatives at cheap rates are Sweden and Denmark. Subsidies to keep down house-building costs constitute an important method of aid in Sweden, Denmark and Switzerland. Another method

¹¹ "Co-operative Housing".

is the grant and acquisition of land. Technical assistance is also supplied in many countries. In Australia the Government guarantees repayment of loans taken by societies from private financial institutions. In the U.S.A., the Federal Government constructs houses at its own costs and offers them to groups organised on the basis of self-help.

The Industrial Housing Scheme

To the normal-time mechanism of private house-financing was added, in the post-war period, a new important item in the shape of an Industrial Housing Scheme, sponsored and supported by the Government of India. In pursuance of the programme of house-building suggested in the Industrial Truce Resolution of December, 1947, and announced as a part of the Statement on Industrial Policy on April 6, 1948, the Government of India drew up in 1949 a Scheme in terms of which the capital required should be provided to the extent of two-thirds as an interest-free loan, repayable within 20 years, by the Government of India and one-third by the State Government or an employer sponsored by the latter. Employers' contribution would be in the form of rent for quarters allotted to their workers (which should not exceed 3% of the total cost). Employees' contribution would be in the shape of rent for their quarters which would be 20% of their wage. Houses built were to be the property of the owners.¹² Under this Scheme, a sum of Rs. 1 crore was advanced as loan to several State Governments (Rs. 75 lacs to Bombay, Rs. 10 lacs each

¹² Government of India, Ministry of Labour, Letter No. Fac. 32(30), of April 13, 1949.

to Orissa and Madhya Pradesh, and Rs. 5 lacs to Bihar) in 1950-51 and Rs. 1'68 crores in 1951-52¹³.

The 1949 Scheme was abandoned towards the end of 1951 owing to unsatisfactory response from the State Governments and employers, and a new plan was evolved instead early in 1952. This plan provided for subsidies, instead of loans, to employers sponsored by the State Governments. The Central Government would subsidise construction to the extent of 20% of the total cost if employers complied with the prescribed conditions, according to which the rent recoverable from a worker should work out at 2% of the total cost but should not exceed 10% of the total earnings of the worker and the members of his family.¹⁴

But even this scheme had to be changed within a very short time. In September, 1952, the Government of India announced a revised Industrial Housing Scheme for 1952-53, meant to provide accommodation for industrial workers through the agency of State Governments, Statutory Housing Boards where they existed, employers and registered housing co-operatives of workers. Over Rs. 7 crores were allotted for the construction of 28,500 tenements. The State Governments were to receive grants totalling Rs. 373'50 lacs, half of it as subsidies and the rest as loans at 4¼% per annum repayable in 25 years, employers and housing co-operatives for workers Rs. 137'25 lacs as subsidies and Rs. 205'875 lacs as loans, at 4¾% and 4¼% respectively, repayable in

¹³ Government of India, Ministry of Labour, Letter No. LWI-Dy. 6281 of Oct. 27, 1951, and the *Statesman*, Nov. 12, 1951.

¹⁴ Source : P. C. Jain, "Problems in Indian Economics" (1955 ed.), p. 192.

15 years. The loans and subsidies to employers would be given direct by the Government of India, whereas loans to local bodies, co-operatives and Housing Boards were to be made through the State Governments concerned who would guarantee them.¹⁵ As the new plan put relatively lesser financial burdens on the State Governments and employers, it was expected to meet with greater success. In a revised scheme the loan-cum-subsidy programme has been extended upto March 31, 1956. The revision raised the maximum duration of the loans to co-operatives to 25 years. According to the Report of the Central Ministry of Works, Housing and Supply for 1953-54, Rs. 4.04 crores were granted as loans and Rs. 3.7 crores as subsidies upto the end of January, 1954. In August 1954, the Government of India sanctioned Rs. 3.14 crores for loans and subsidies.¹⁶

Other Developments

The problem of rural housing, somewhat different in nature from that of urban housing, has come to receive the attention of the State in recent years. For it is also a vast one, involving as it does some 83% of the entire population of the country. In the First 5-Year Plan it has been suggested that the State Governments should provide funds for house construction in rural areas "by issuing interest-free or long-term loans".

Recently a very welcome addition has been made to the normal-time machinery of financing private housing. The Central Government has announced (in 1954) a

¹⁵ *The Statesman*, Sept. 25, 1952.

¹⁶ Source : P. C. Jain, *op. cit.*, p. 194.

scheme* under which funds will be placed at the disposal of the State Governments for lending to co-operatives or even private individuals on the security of land and buildings. An individual may get a sum upto Rs. 8,000 at 4½% as a long-term loan so that he may have a house of his own. This measure is bound to act as an incentive to private house building.

Financing Emergency Housing Schemes

The Second World War and the Partition created certain groups of people whose housing problems, because of their complicated and urgent character, required solution on an emergency basis. Ex-service personnel and refugees are the two most important emergency groups arising out of the War and the Partition respectively. As regards war veterans' housing, no separate scheme exclusively intended to supply housing finance exists. Housing finance is granted as a part of the general assistance measures for ex-service men and women which we have already discussed and need not, therefore, repeat here.

The experience of refugee house financing would be studied in details in a subsequent chapter on refugee financing. It would suffice to point out here that one important feature of rehabilitation financing is the Central programme of setting up Housing Finance Corporations on a State-cum-private-ownership basis.

Aid by way of subscription to the share capital of house building and/or financing institutions has been extended to an appreciable extent in Belgium and the

* *Hindustan Standard*, 1954 Supplemer

U.S.A. In Belgium, the State and local bodies have participated in the ownership-capital of "approved" building societies. In America, the Federal Government has subscribed to the shares of the 12 Federal Home Loan Banks, while the Reconstruction Finance Corporation (a government agency) has contributed to the capital of the National Mortgage Association. But whereas the Indian Housing Finance Corporations construct houses for sale on hire-purchase terms, the U.S. Home Loan Banks do not undertake direct building.

Conclusion and Remarks on Housing Finance

Viewing the system as a whole, it becomes evident that by far the largest portion of the financing is done by government departments directly and only a small part is handled by specialised agencies. Nevertheless, the recent trend points towards a gradual change-over to the institutional approach. This is in keeping with the broader international trend of creating State-aided agencies specialising in housing finance as evinced in advanced countries of the west. The system of the 12 Federal Home Loan Banks supervised and co-ordinated by the Federal Home Loan Bank Administration together with the Federal Housing Administration in the U.S.A. furnishes perhaps the best illustration of such specialisation. We conclude by suggesting that the Indian system can be broadened by conferring powers of financing house construction and purchase upon the State Financial Corporations in order to supplement the undeveloped and inadequate co-operative machinery.

CHAPTER V

THE INDUSTRIAL FINANCE CORPORATION OF INDIA

The creation of the Industrial Finance Corporation of India in 1948 represents a major attempt on the part of the Government of India to explore a wider and more desirable horizon in the sphere of public assistance to private industry. Already before the Second World War in some regions of the world, the era of departmental financing of private enterprise had been gradually transformed into one of aid mainly through specially created government financial machinery. In the Europe of the 'twenties the experiment chiefly took the shape of constituting industrial mortgage banks in which the Governments concerned accepted financial stakes in several forms. In the 'thirties interest shifted on to the flotation of industrial finance corporations, although, really speaking, the epoch in which the task of organising such corporations was to be undertaken on a truly large and almost international scale was deferred until the 'forties. Both these mortgage banks and the finance corporations are institutions specialising in industrial financing, and the object of both is the same, viz., to render generally long and intermediate-term financial aid to private industries, especially small and middle-sized concerns which in every country confront the greatest difficulty in securing sufficient capital at reasonable cost. But the fundamental distinction between these two institutional types lies in that in contrast to the industrial finance

corporations, the industrial mortgage banks have not usually combined the business of loan-making with that of facilitating ownership capital. The concept of the I.F.C., wider than that of the I.M.B., has been found suitable by a large number of countries in both hemispheres for the purpose of accelerating industrial development on a mixed-economy basis. As examples of existing public or semi-public industrial finance corporations working on a national* scale, we might mention, besides the I.F.C. of India, the Industrial Finance Corporation of Pakistan, the Reconstruction Finance Corporation of the U.S.A., the Industrial Development Bank of Canada, the Industrial and Commercial Finance Corporation, and the Finance Corporation for Industry of Great Britain, the Industrial Finance Department of the Commonwealth Bank of Australia (for all practical purposes a separate institution), the Reconstruction Finance Bank of Japan, and the Industrial Banks of a number of Latin American countries.† An important characteristic of such I.F.C.'s—one which distinguishes them from another class of public financial agencies, viz., the industrial development corporations which some backward and under-developed States of the world such as, Pakistan, South Africa, several South American States, and very recently India, have created—is that they do not as a rule undertake the business of themselves setting up and running, tempo-

* And not regional.

† Some small countries have found it economical and otherwise convenient to invest their national industrial finance corporations with powers to finance agriculture and other non-industrial activities, for instance, the State Advances Corporation in New Zealand and the Rehabilitation Finance Corporation in the Philippines.

rarily or permanently, industrial concerns, over and above that of helping private concerns.

Though the Indian I.F.C. was set up as late as 1948, the notion of a State-aided specific financing machinery is much older in India. The Industrial Commission of 1918 recommended an institution on the analogy of the Industrial Bank of Japan (1902). A similar idea was reborn in the deliberations of several Banking Inquiry Committees a decade later. Of course, some of the Provincial Banking Inquiry Committees and the majority of the Indian Central Banking Inquiry Committee were in favour of regional, instead of all-India, bodies. In the wake of these reports Dr. P. S. Lokanathan, in his classic work "Industrial Organisation in India" (1935), supported the case for provincial industrial banks of the type which flourished in Germany after the First World War, carrying on both deposit and investment banking businesses, and concentrating chiefly on railroads and public utilities. The 'foreign experts' of the Central Banking Inquiry Committee had desired an agency, somewhat akin to Lokanathan's, to help exclusively public utilities on an all-India basis. A few years later Dr. S. K. Basu, another respectable writer on industrial finance, in his incomparable book "Industrial Finance in India" (1939) voiced the opinion that an organisation, closely modelled on the lines of the Post-World-War I industrial mortgage banks of Europe, would be eminently suitable for India. During the 'forties the trend of discussions gradually shifted from the concept of a purely I.M.B. to that of an I.F.C. But whatever the character of the organisational type advocated, the debate had all along emphasised the need for specialised government agencies

to make available long-dated finance to small business, the worst sufferer from the chronic inability of our private financial mechanism to supply industrial enterprise with all the requisite money.

The I.F.C. of India sprang into existence on July 1, 1948, amid such a historical setting. The purpose of the Corporation, in terms of the preamble to the Industrial Finance Corporation Act of 1948, is one of "making medium and long-term credits more readily available to industrial concerns in India, particularly in circumstances where normal banking accommodation is inappropriate or recourse to capital-issue methods is impracticable." The object is evidently to supplement, and not supplant, the inadequate private financial organisation.

The authorised capital is Rs. 10 crores, Rs. 5 crores having been issued in the first instance. The shareholders are the Central Government, the Reserve Bank of India, scheduled banks, co-operative banks, insurance companies, investment trusts and other financial institutions, but no individual. The Central Bank and the Reserve Bank may transfer their shares to the other holders. The practice of leaving out individual investors has also been pursued by several foreign industrial finance corporations, e.g., the British I.C.F.C. and the F.C.I., the Pakistan Industrial Finance Corporation, the I.D.B. of Canada, and the R.F.C. of the U.S.A.

Under Section 5 of the I.F.C. Act, 1948, the Central Government has guaranteed a $2\frac{1}{4}\%$ dividend per annum on the share capital. The Corporation can supplement its resources by selling bonds guaranteed by the Central

Government as regards principal and interest. It can accept deposits from the public up to Rs. 10 crores on certain conditions. The old Industrial Bank of Japan used to cultivate this practice on a large scale. But some finance corporations, e.g., the F.C.I. of Great Britain, do not carry on deposit business. The amendment of the I.F.C. of India Act in December, 1952, (a) empowered the Central Government to guarantee loans in foreign currency which the I.F.C. may seek from the International Bank for Reconstruction and Development or otherwise for the purpose of lending to industrial concerns, (b) authorised the I.F.C. to borrow from the Reserve Bank against Government securities for short periods not exceeding 90 days and also to get loans from the same upto Rs. 3 crores for periods not exceeding 18 months against bonds and debentures issued by the I.F.C. or against such other security as may be required by the Reserve Bank, and (c) provided for the creation of a Special Reserve Fund rising upto Rs. 50 laks.

Nationalised industries have been expressly excluded from the province of the I.F.C. But this does not imply that it can help all sorts of private industry. According to the 1948 Act, it can assist only public limited companies and co-operative societies engaged in the manufacture or processing of goods, or in mining, or in the generation and distribution of electricity or any other form of electric power. An identical limitation has been placed on the Pakistan I.F.C. But the Canadian I.D.B. and the English I.C.F.C. have not excluded partnerships or private limited companies from their scope. The amendment of 1952 has enabled the I.F.C. to assist shipping companies.

Section 23 of the 1948 Act empowers the Corporation to help private industry by the following devices :—

- (i) Guaranteeing loans raised by industrial concerns which are repayable within 25 years and floated in the public market ;
- (ii) Underwriting the issue of stock, shares, bonds and debentures issued by industrial concerns ; and
- (iii) Making loans or advances to, or subscribing to the debentures, but not shares, of industrial concerns, repayable within 25 years.

No accommodation is to be allowed by way of guarantees or loans unless it be secured by sufficient pledge, mortgage, hypothecation, or assignment of Government or other securities, or other tangible assets. According to the original Act, aid to a single concern could not exceed 10% of the paid-up share capital of the I.F.C. or Rs. 50 lacs, whichever was larger. The Amendment of 1952 raised the maximum limit of a loan to Rs. 1 crore. Similar ceilings upon the size as well as the duration of assistance have characterised such corporations all the world over. Indian legislation has not, however, explicitly fixed any minimum size or duration of the I.F.C. aid. This implies that the I.F.C. would be able to supply even current finance if circumstances require, and in India circumstances have not been rare when a panic-stricken money market has failed to provide short-term funds even to well-established concerns.

The I.F.C. cannot directly subscribe to shares and stocks of any public limited liability company. The same is the case with the Pakistan I.F.C. and the Indus-

trial Bank of Venezuela. On the other hand, a large number of similar financial institutions abroad, e.g., the Reconstruction Finance Corporation of the U.S.A., the Canadian I.D.B., the British I.C.F.C. and the F.C.I., the Reconstruction Finance Bank of Japan, the Industrial Finance Department of the Commonwealth Bank of Australia, and the Industrial Credit Bank of Argentina, possess the power of direct contribution to share capital. The policy of several of these agencies, however, is not to retain these shares for ever but rather to attempt their transfer to the public at propitious times so as to be able to release their valuable funds for re-employment.

The I.F.C. of India at Work

The I.F.C. of India has not undertaken any underwriting operations up till now (i.e., up to 1954). An identical explanation has been given in all the Annual Reports, namely that, the I.F.C. does not deem it advisable to accept such commitments under the existing unsatisfactory conditions of the financial market. Nor has it done any guaranteeing business so far. For the present it has concentrated on the loan-method of assistance.

During the six years ended June 30, 1954, loans worth Rs. 20'74 crores were sanctioned, out of which Rs. 2'59 crores were declined by the applicants and Rs. 67 lacs were withheld by the I.F.C. The rate of interest charged by the Corporation was, until the end of 1951, 5½%, with a rebate of ½%, if the interest and the instalments of principal were paid on due dates. It is 6½% at present, with, of course, a ½% conditional

rebate. During the six-year period as a whole, the largest amount of loan, namely Rs. 3'07 crores, was granted to the cotton textile industry. Other important recipients are the cement and paper industries. Out of the 137 applications (by 108 companies) which were sanctioned since the commencement of the I.F.C. upto June 30, 1954, the largest number, 78, was for amounts of less than 10 lacs each. There was just one loan between Rs. 90 lacs and Rs. 1 crores. There is no legal bar to the granting of current finance, and the I.F.C. has actually allowed, where necessary, reasonable amounts for working capital purposes to new firms in addition to their block capital requirements.

Critical Examination of Powers and Operations

Six years of I.F.C. financing afford some opportunity to offer criticisms of I.F.C. policy and indicate desirable courses of action suggested by the needs of an economy having no developed money or capital market. Such criticisms are capable of a three-fold classification : (a) criticism of assistance rendered under legally permissible powers, (b) criticism of these very powers determining the scope of the I.F.C., and (c) miscellaneous criticism aimed at the structural features of the I.F.C.

(a) In contrast with the policy of the majority of similar institutions abroad, the I.F.C. of India's policy has been to confine attention to large-scale industry. But the financial difficulties of large-scale industry have not disappeared to any remarkable extent under the impact of its operations so far. The composition and size of I.F.C. assistance are quite inadequate. Abstention

from guaranteeing and underwriting, whatever the reasons, has simply strengthened the notion that the I.F.C. wants to be no better than a fair-weather friend of private industry. The utter inadequacy of the size of the loans will be evident from the fact that more than 50% of the borrowing concerns received loans not exceeding the Rs. 10-lak limit. The cotton textile industry has so far received Rs. 3.07 crores from the I.F.C., whereas "on a conservative estimate, cotton mills in Bombay city alone would need more than Rs. 100 crores to carry out their rehabilitation programme."* The extent to which large-scale enterprise can pin much hope to the I.F.C. can be easily guessed.

The terms and conditions of the loans have also been criticised. Insistence on the personal guarantee of the managing agent is really a rigorous condition. But the complaint of high interest rates is not, in general, valid. Of course, lower rates in special circumstances and cases are desirable. The Shroff Committee has recommended that where the I.F.C. is satisfied that the managing agent has a reasonable financial stake in the company to which a loan is granted, and is also regarded as eligible in other ways, the additional guarantee of the managing agent need not be insisted upon.

It is surely not too much to expect an all-India institution like the I.F.C. of India to promote through its operations a balanced regional dispersal and development of industry, especially when some such thing is held as one of the objectives of industrial policy by the

* "Facts about the Cotton Mill Industry of India" (1953), the Millowners' Association, Bombay.

Government of India. But in practice, the Corporation has done its opposite. Its loans have been given mostly to the already heavily industrialised States of the Union.†

There appears to be no good reason as to why the I.F.C. should not commence the business of loan-guaranteeing now that dear money has staged a comeback. It may be suggested that a re-adaptation of the Reconstruction Finance Corporation Plan for "Blanket Participation Agreements" of March 1, 1945, or that for "Small Loan Participation", which succeeded the former on its termination in January, 1947, to the needs of big business might prove of immense utility in India. These guarantees in the U.S.A. were given in connection with bank-made industrial loans of certain size and maturity.

(b) But even if the I.F.C. had fully cultivated all the legally permissible methods of financial aid, it could not have met all the vital requirements of Indian industry. For larger defects have been found, not in any conservative application of the 1948 Act by the Corporation, but in the Act itself. First of all, the Rs. 50-lak limit upon the maximum size of permissible loan to a single concern had seriously reduced the Corporation's importance as a financier of large-scale industry. Even the present limit of Rs. 1 crore is grossly inadequate. Perhaps it is this factor which partly explains the approach by some key industries in India (e.g. iron and steel) direct to the Government of India for loans to carry out their expansion and modernisation programmes. The Shroff Committee has rightly argued

† *Viz.*, Bombay, West Bengal, and Uttar Pradesh.

that the Rs. 1-crore limit should be relaxed in the case of key industries. Secondly, and this is crucial, the ban on direct subscription to share capital has snatched the largest slice away from the utility of the I.F.C. in the sphere of long-term production finance. The I.F.C. of Pakistan, India's next-door neighbour, is no doubt subject to a similar prohibition of the direct participation business. But we cannot be blind to the fact that this deficiency of the Pakistan Industrial Finance Corporation has been amply made good by the creation of the Pakistan Industrial Development Corporation empowered to participate in the ownership capital of private industry. Until quite recently, India has had no such development corporation. In 1952 this author wrote, "If the Government of India is not keen on setting up a similar industrial development corporation in the near future to supplement the I.F.C. of India, it should consider the case of rendering the I.F.C. Act of 1948 more broad-based by including a clause authorising the Corporation to participate, whenever necessary in the national interest, in the risk capital of private industry."^{*} Now that we have two industrial development corporations there is no longer any need for enabling the I.F.C. to purchase shares. But at the same time he is forced to point out that there is little logic in keeping the I.F.C. off from direct participation after empowering it to undertake underwriting which is no less fraught with risks.

(c) The absence of a technical expert staff to carry on research work is certainly an organisational defect

^{*} *Vide* my article "The Story of the Industrial Finance Corporation of India", *Calcutta Review*, March 1952.

of the I.F.C. of India.† But this is partly recompensed by the fact that the Corporation is getting the services rendered by the Council of Scientific and Industrial Research in examining the technical aspects of proposals for aid. It is also being assisted by the various Central Ministries in this respect. It seems, then, that the creation of a separate Department of Economic Research, as in the British I.C.F.C., is not at present a very important problem.

Conclusion

The I.F.C. of India has proved a misnomer in practice. It has been working virtually as an industrial mortgage bank. It has not even cultivated all its statutory powers. This state of affairs should end as early as possible. The Corporation may further be considered as an integral part of our central banking system so that its policy may be always well-co-ordinated with the financial part of our development plans whose best executor is certainly the central banking institution in any country.‡

† Specially stressed by Dr. S. K. Basu in his "Industrial Finance in India", ch. xv.

‡ Sources from which data about the foreign agencies cited in this chapter have been collected : Report of the EACF Committee on Industry and Trade (3rd Session, Feb. 1951) ; U.N., "Economic Development in Selected Countries" Vol. I and Vol. II, and "Economic Survey of Asia and the Far East, 1948" ; and S. K. Basu, "Financing Post-war Industry" (1948).

CHAPTER VI

THE TWO INDUSTRIAL DEVELOPMENT CORPORATIONS

Recently, two all-India institutions have been set up which will have far-reaching effects on the development of our economy in future. The first is the National Industrial Development Corporation wholly sponsored, owned and managed by the Government of India, and the second is the Industrial Credit and Investment Corporation, privately sponsored, but supported and assisted by the Government of India. The decision to establish the N.I.D.C. was taken by the National Development Council in October, 1953, as a part of the expansion of the First Five-year Plan. Such a step was but inevitable. In the under-developed economies of Asia and the Far-East, with capital markets either inadequate or virtually non-existent, financial agencies are required not only to lend to existing enterprises but also to initiate, underwrite, and participate in new undertakings, so that a broad-based, diversified industrial development may take place and the pace of industrialisation itself accelerated with consequent increase in real income and employment. As early as March, 1952, when the First Five-year Plan was still in the preparatory stage and financial economists in the country were failing to extend their imagination beyond an I.F.C. authorised to subscribe to industrial shares, the present writer had the boldness to declare, the Indian I.F.C. should be empowered not only to participate in risk and ownership capital of

.....companies, but also to float its own companies in industries where private investment is not forthcoming at the requisite rate. That is to say, the I.F.C. should be converted into an Industrial Development Corporation unless, of course, the Union Government is going to create such a Corporation, in addition to the existing I.F.C., as in Pakistan.”¹ His conclusion was that “it would not be very surprising if the lesson of the 'fifties is going to be that the financial interests of Indian enterprise are best served by specialist government institutions of a type *significantly different* from the existing I.F.C. of India with its unduly restricted sphere of financing.”² This observation was based mainly on the experience of some of the Latin American countries—to which I have already referred in the previous chapter—where the major technique of financing investment in both the public and the private sectors had taken the shape of establishing industrial development corporations. The following were the chief reasons that had compelled experimentation with such a technique: (i) private industries were unable to raise all the requisite funds owing to the undeveloped or under-developed state of capital markets; (ii) private enterprise was rather reluctant to shoulder the risks of pioneering in certain basic and key industries which, nevertheless, had to be developed in the interests of the community; and (iii) due to this failure of investment to take place on the requisite scale in the private sector, the unemployment problem was assuming serious proportions. All these factors have been in existence in this country

¹ My article in the *Calcutta Review*, March, 1952.

² *Ibid.*

for a long time. To these we might add two others in order to arrive at all the important reasons underlying the creation of industrial development corporations in India.† First, the industrial policy of the Government of India, as announced in April, 1948, has made the State, and not private enterprise, “exclusively responsible for the establishment of new undertakings” in certain basic and key industries. Secondly, as a result of World War II, the entrepreneurial class with capital is fast disappearing, though entrepreneurial skill is there, and “with individual entrepreneurial capital fading into oblivion, the need has arisen for special institutions to sponsor new industries requiring large investments and to provide long-term capital needed by existing industries for expansion and modernisation.” The declining significance of the managing agency system deserves special notice in this connection.

Thus, the inability of the financial mechanism to supply industries, public as well as private, with the necessary long-term funds, especially risk capital, reluctance of private enterprise to venture in new fields under existing socio-economic conditions, the industrial policy of the Govt. of India, and the declining role of individual capital—all these factors invest the new development corporations with tremendous importance in our industrialisation programme. By the by, this recent development also points to the gradual decline of departmental financing which has already received a severe blow at the creation of the I.F.C. of India and its small counterparts in several States.

† The State-owned Development Corp. in particular.

The National Industrial Development Corporation, a purely government agency, was formally registered on October 20, 1954, with a share capital of Rs. 1 crore.³ Its capital resources would be augmented from time to time by advances from the Central Government. Moreover, it can accept deposits and issue debentures. It will assist any industrial enterprise, firm or individual, State-owned or private, which will contribute to industrial development. It may set up its own factories, run them and may transfer them to private ownership and management after some time. It will also try to develop mines and land, set up and maintain research agencies and experimental workshops. It will take particular interest in the development of basic and capital goods industries where private capital may not be forthcoming. It will supply real capital in the form of equipment, facilities and technical aid, and loan and risk capital by subscribing to as well as underwriting industrial shares and debentures.⁴

The Industrial Credit and Investment Corporation was set up in January, 1955. Its paid-up capital is Rs. 5 crores,† of which Rs. 3·5 crores will be subscribed by Indian investors—institutions and individuals—and of the balance, two-thirds will be taken up by British investors and one-third by U.S. investors. It is a privately owned and managed institution, having the support of the Govt. of India and the International Bank for Reconstruction and Development. The Central

³ Information supplied by the Govt. of India.

⁴ S. K. Basu, "Industrial Development Corporations" in the Indian Journal of Commerce, Vol. VII, no. 28, 1954.

† Authorised capital is Rs. 25 crores.

Government has placed at its disposal Rs. 7½ crores from the counterpart funds arising out of the American economic aid under the technical assistance programme as interest-free loan for 15 years and repayable after this period in 15 equal annual instalments. The I. B. R. D. has agreed to give it a loan of \$10 mn. guaranteed by the Govt. of India. x

The I. C. I. C. will encourage industrial development in the private sector by making loans either for the establishment of new industries or for the expansion and rehabilitation of existing ones. It will participate in the share capital of concerns promoting new ventures or underwrite the issue of such concerns. In addition, it will, if necessary, supply them with technical know-how by getting experts from abroad. It will not attempt to have a controlling interest in the capital structure or management of the industries concerned. "As the object of the Corporation is not to own industries but to help in establishing as large a number of them as possible, it will dispose of the shares or debentures it takes up whenever possible. By doing so, it will be in a position to keep its assets constantly revolving." Thus, while the N. I. D. C. will both run and assist industries, the I. C. I. C. will chiefly assist, and not run, industries in the private sector. So far as the financing of private industry is concerned, the I.C. I. C. looks more important than the N. I. D. C. But the employment potential of the latter is much greater. If these two agencies can do nothing except augmenting the meagre supply of technical know-how and managerial

⁵ Commerce, Nov. 20, 1954, p. 953.

services in this country, they will have rendered yeomen's service to the cause of industrialisation indeed.

Industrial development corporations exist in most of the States of under-developed Latin America, in South Africa and Pakistan. We already have referred to them in Chapter V. A brief analysis of some of these industrial development corporations would be very useful in appraising our own Corporations. Institutions which are statutorily industrial development corporations, or virtually so, are at work in Mexico, Argentina, Bolivia, Venezuela, Puerto Rico and Colombia. There is a Federal Industrial Development Commission (1944) in Mexico which plans, finances, organises and establishes industries which, although essential in national interest, have not been set up by private enterprise, and also contributes a part of capital required by private industries.⁶ The Industrial Credit Bank of Argentina (Banco de Credito Industrial, 1944), a full-fledged government agency, has a special Section, called the Industrial Promotion Section, which is authorised to direct loans to industries, market issues of industrial stock and debentures, form and participate in enterprises, exercise trusteeship and make grants to further technical development.⁷ The Bolivian Development Corporation (Corporacion Boliviana de Fomento), operating since 1943, is conceived as an instrument for an integrated economic development. The State owns 95% of its shares. It functions through four departments, namely, the Dept. of Public Works, the Dept. of Agriculture, the Dept. of

⁶ U. N., "Economic Development in Selected Countries" Vol. I (1947).

⁷ *Ibid.*

Mineral Resources, and the Dept. of Industries and Commerce.⁸ The Mining Bank (Banco Minero de Bolivia) of Bolivia (1936) is for all practical purposes a specialised industrial development corporation. Its objectives are to develop extractive industry by credits to enable miners widen their activities, to co-operate in the exploitation of mineral products with small mining units, to adopt various measures for reducing production costs, to organise mining enterprises, to participate in private mining concerns, and to disseminate improved methods to firms.⁹ The Venezuelan Development Corporation (Corporacion Venezolana de Fomento, 1946) performs the following functions : it increases national production, discovers new lines of production, and improves or rationalises those now being exploited, gives technical and financial aid to public and private enterprises for the establishment of new industries and the improvement of existing ones, and adjusts all these activities to targets which might be fixed by a General Production Development Plan. Besides itself establishing firms, it may assist, with technical services, loans, participations and guarantees, private enterprises which initiate or expand any line of national importance.¹⁰ The Production Development Corporation of Chile (1939)¹¹ "is one of the first and most active development corporations organised in Latin America." The Industrial Development Corporation of Pakistan is authorised to sponsor public companies for a specified group of industries vital to the Pakistan economy, to underwrite whole or part of the share capital of such companies, or subscribe, on behalf of the Pakistan Government, any

⁸ *Ibid.* ⁹ *Ibid.*

¹⁰ *Ibid.* ¹¹ *Ibid.*

portion of their issued share capital not taken up by the public, and itself set up industries which may, in course of time, be transferred to private ownership and management.¹² In 1950 the Turkish Government decided to support the creation of an Industrial Development Bank which would be an exclusively private concern, and which would stimulate and assist the establishment of new private industries and expansion or modernisation of existing plants, encourage and assist the investment of private capital, domestic as well as foreign, and assist in the development of a broader security market in Turkey. (The close similarity between this agency and the Indian I.C.I.C. is noticeable).¹³ Utilisation of foreign funds is a common feature of some of these development corporations (e.g. the Bolivian Development Corporation and the Production Development Corporation of Chile). In India, besides the I.C.I.C. which has foreign participation in its capital, the I.F.C. is also authorised to seek loans from the International Bank.

Without investment on a massive scale the problems of low living standard and unemployment in an under-developed country cannot be solved. An increasing part of this investment must occur in the expanding industrial sector of agricultural India. A considerable portion of this investment will be channelled, directly or indirectly, through the two all-India Development Corporations. These two institutions represent the latest trend in the field of industrial promotion and financing in this country.

¹² Report (1951) of the ECAFE Committee on Trade & Industry (3rd Session).

¹³ Capital, Sept. 7, 1950.

CHAPTER VII

SPECIALISED INDUSTRIAL FINANCING MACHINERY IN THE STATES

The most remarkable trend of post-war government financial assistance to private industry in India is the increasing attempt to extend such assistance through newly-organised specialist financial institutions. The creation of the I.F.C. of India in 1948 was the first major step in this direction since World War II. In statutory terms, there was nothing to prevent this all-India agency from catering to the requirements of medium and small-sized enterprises provided these were public limited companies, or to those of still smaller businesses provided they were organised on a co-operative basis. But in practice, the Central I.F.C., quite unlike similar corporations in some foreign countries like the U.K. and the U.S.A., came to confine itself to the task of financing large-scale industries only. This exclusion of small business from the scope of the I.F.C. of India left, thus, a wide and serious gap in the mechanism of institutional financing. The plan to fill this gap has taken the shape of setting up a network of smaller I.F.C.'s, one in each State, to concentrate exclusively on assistance to medium and small-scale concerns. The passage of the Small Financial Corporations Act in 1951, which has enabled the States to establish industrial finance corporations of their own, is evidently an event by no means less significant than that of the I.F.C. of India Act in 1948.

Of course, from the historical standpoint specialist regional government agencies are not in any way

exclusively post-war phenomena. Industries in Hyderabad have been receiving financial aid from the Hyderabad Industrial Trust Fund which sprang into existence as early as 1928. In Bengal, an Industrial Credit Syndicate was brought into being in 1936 with the support of the Bengal Government to supply long-term finance to small industries. This institution, having an authorised capital of Rs. 50 lacs, was principally intended to help industries to be started by ex-detenus trained under the Government's Unemployment Relief Scheme for the Educated Unemployed among the Middle Classes. The Government granted certain special facilities to the Syndicate, including an annual contribution towards its administrative cost. Under the defective management of a managing agency firm and following an unsound procedure, the Syndicate failed to attract sufficient capital from the open market and to render, naturally enough, adequate financial help to the borrowers. It was ultimately wound up in 1939; and by that time it had raised only Rs. 1,52,170 worth of capital and advanced approximately Rs. 87,094 at 6 p.c. Following the lead of Bengal, the U.P. Government set up the U.P. Industrial Finance Corporation in 1938. The U.P. Government agreed to give it 4% on its paid-up capital, 50% of management cost in excess of Rs. 20,000 annually, and 1¾% towards its reserve fund on the amount invested by the Corporation, the liability not exceeding Rs. 50,000 each year for 15 years. The Government also guaranteed a tax-free 4% on its shares. Loans were available from the Corporation for both long and short-term purposes, and these were confined to industrial concerns having a capital not exceeding Rs. 50,000. This

corporation, too, failed to come up to expectations. It could not secure enough private funds to operate successfully, and gradually ceased to function.¹ In Travancore, a government agency, namely the Travancore Credit Bank, came into being in 1938 for making both short and long-term loans to industry (as well as agriculture). It has been functioning ever since.

The unhappy experience of the Bengal and U.P. institutions did not, however, imply any futility or undesirability of erecting a specialised industrial financing machinery with State aid. For it is now clear that it was the utter inadequacy of State commitments together with some glaring managerial defects that led to their undoing. The two Governments concerned did not take up the shares of these two agencies at a time when the capital market was in a state of virtual collapse under the impact of the Depression, and private investors—individuals as well as institutions—were not finding any government guarantee strong enough to overcome their high liquidity-preference. In these conditions their starvation unto death became only a question of time.

During and after World War II, several expert Committees sponsored specific proposals for financial agencies in the States, upon a somewhat revised model, with larger and direct State participation in their capital resources. The reports of the Bombay Economic and Industrial Survey Committee in 1940, the Bengal Industrial Survey Committee and the Industrial Finance

¹ Source : Report of the Bengal Industrial Survey Committee (1948), pp. 326-7.

Sub-Committee of the National Planning Committee in 1948, the Indian Fiscal Commission in 1950, and the West Bengal State Industrial Finance Corporation Committee in 1951 may be mentioned in this connection. The recommendations contained in some of these studies had beyond doubt influenced the legislation of 1951. For, in it the Government of India provided for larger and direct contributions by the State Governments to the resources of the new Corporations. Before we proceed to analyse this new machinery, it would be useful to say something about those few State agencies which were created in the inter-war period, and which, unlike the Bengal and U.P. institutions, have been functioning with success even unto this day.

Financing Agencies other than State Financial Corporations

The Hyderabad Industrial Trust Fund and the Travancore Credit Bank have already been mentioned. These are specialist agencies, different from what is suggested by the concept of the I.F.C. The Travancore Credit Bank, incorporated in 1938 with most of the shares owned by the State Government, is really nothing more than an industrial mortgage bank so far as its industrial financing activities are concerned. Loans are given for both short and long-term purposes, the maximum duration being 20 years.²

The Hyderabad I.T.F., established in 1928 with a corpus of Rs. 1 crore, is a unique agency which forms a class by itself. As a result of annual increases its

² Letter from the Secretary, T. C. Bank, No. 1595, dated 14-2-1952.

total funds stood at about Rs. 5-crores in mid-1951, a substantial portion being the contribution of the Government. The income from the Fund is utilised for such purposes as (1) the improvement and development of cottage and small-scale industries, (2) industrial experiments and demonstrations, (3) economic and industrial enquiries within Hyderabad, (4) grants-in-aid to finance industrial and technical research work, and (5) grant of aid and scholarship to youngmen for training in industrial processes. Private industries are financed by such devices as loans and contributions to shares. By mid-1951 the Fund was holding shares of 23 companies of the face-value of Rs. 1,32,18,392, and its loans to joint-stock companies, firms, individuals and Govt. Departments stood at about Rs. 340 lacs. On average Rs. 1 lak were the annual outlay on industrial scholarships. Agencies of 8 concerns were vested in the Fund.³ Evidently, the Fund is more than a modern I.F.C., for no such I.F.C. has undertaken so many functions at a time. Nor can it be compared to industrial development corporation. It is not interested in setting up and developing, on its own initiative, industries, to be owned and managed in the initial stages wholly by itself in the manner of such a corporation. Really, the Fund has no exact counterpart in any other part of India, if not in the whole of the mixed-economy world.

In Saurashtra, the Government-owned State Bank of Saurashtra, formed in early 1950 by the amalgamation of the different State Banks of the covenanting States

³ Source : Hyderabad Govt. Bulletin on Economic Affairs, April-June 1950, and June-July 1951, p. 446.

forming the Union, grants long-dated loans to private industries whose loan applications have been recommended and forwarded to it by the Industries and Commerce Department. The interest charge is 5% per annum or 2% above the Bank Rate, whichever is higher. A loan can be made up to 40% of the value of the buildings and machinery on which the loan is to be secured. The Government affords the Bank a guarantee that in the case of default it would pay to the Bank such sums as might remain uncovered.⁴

In Hyderabad, a similar agency, namely the Hyderabad State Bank, has been providing working funds to various industrial units from long before the Second World War. Moreover, the Bank has been financing exports for some time. During 1948, 1949 and 1950, it financed about 75% of the total exports of non-controlled goods from Hyderabad.⁵ It is not so easy to classify these State Banks, which some Part B States (e.g. Hyderabad, Mysore and Saurashtra) possess. They are quasi-central banks, so to speak. They have really no parallel in foreign countries.*

There can be no better testimony to the inadequate character of the assistance rendered by these financial agencies than the fact that even in the States where they exist, the Governments concerned have displayed increasing willingness to set up State I.F.C.'s on the

⁴ Finance Dept., Saurashtra, Memo. No. 42/48 - of 2-6-1951. 3707

⁵ Hyd. Govt. Bull. on Econ. Affairs, January 1951, pp. 22-23.

* They assist agriculture, too. These "State-Associated Banks" are expected to be merged in the new "State Bank of India" in the near future.

lines traced out by the State Financial Corporations Act of 1951. And some of these States already possess such Corporations. Inevitably, a considerable part of the work done by these agencies would be gradually absorbed into that of the new Corporations. Nevertheless, as most of these agencies perform important functions besides industrial lending, it seems that they would be able to continue to work even in the future without largely encroaching upon the field of the I.F.C.'s.

In several States, the Governments have been financing cottage enterprises indirectly by making loans and grants to the State Co-operative Banks or similar co-operative agencies for distribution to industrial co-operatives of small artisans. But the outlay has been relatively too small to deserve any detailed discussion here. So, we can gainfully pass on to the study of the system of the State Financial Corporations.

State Financial Corporations

In terms of the enabling Act of 1951, an industrial finance corporation can be established in each State with an authorised capital between Rs. 50 lacs and Rs. 5 crores, to be contributed jointly by the State Government concerned, the Reserve Bank of India, and other private institutions and individuals, the share of private individuals not exceeding 25% in any case (cf. the Central I.F.C. has no private individual share-holders). Such a corporation can supplement its share capital by issuing bonds and debentures up to a certain figure, and these bonds and debentures would carry the guarantee of the State Government in question as to the repayment of the principal and a minimum annual dividend. It is

authorised to attract further funds by accepting deposits from the public to the extent of its paid-up capital, and these deposits are repayable after a period of not less than 5 years from the date of their arrival. Under Section 25 of the State Financial Corporation Act, a State I.F.C. can assist an industrial concern, public or private, "engaged in the manufacture, preservation, or processing of goods, or in mining, or in the generation or distribution of electricity or any other form of power" in the following ways :—

- (1) by guaranteeing loans, raised by industries, repayable within 20 years and floated in the public market ;
- (2) by underwriting issue of stocks, shares and debentures by individual concerns ; and
- (3) by making loans or advances to, or subscribing to the debentures of, industries repayable within 20 years.

All financial accommodation must be adequately secured. Such accommodation to a single concern cannot, under Sec. 26, exceed Rs. 10 lacs. A State I.F.C. is not authorised to subscribe directly to the shares or stock of any company (Sec. 28).

The above are the broad principles which will guide specific legislation for the creation of a financial corporation in each State of India. Within these broad limits it is left to the States to determine the actual ownership, distribution of capital, organisation and financing pattern of their respective corporations. At present State I.F.C.'s exist in Madras, the Punjab (I), Saurashtra, Bombay, Travancore-Cochin, Hyderabad, W. Bengal,

U.P., Bihar, Madhya Bharat, Assam and Rajasthan. The Madras agency, called the Madras Industrial Investment Corporation, was incorporated on March 26, 1949, with an authorised capital of Rs. 2 crores, the Madras government having taken up 51% of the shares and guaranteed upon the rest a minimum annual 3% subject to tax. As the corporation was set up prior to the 1951 legislation, a clause had to be put into that legislation providing for the operation of the Corporation as a State I.F.C. within its meaning.* The particulars relating to the date of establishment, capital structure and the allocation of issued capital to the various categories of shareholders of the corporations of the Punjab (I), Bombay, West Bengal, Saurashtra, Travancore-Cochin, Hyderabad, Assam, Uttar Pradesh, Bihar and Rajasthan are given below :—

* Strangely enough, in the Reserve Bank of India's Annual Reports on Currency and Finance, the Madras I.I.C. has not been mentioned at all.

| Name | Date of Creation | Authorised Capital | Issued Capital | Distribution of Issued Capital (Rs. in lacs) | | | |
|---|------------------|--------------------|----------------|---|--------------|--------------------|--------|
| | | | | State Govt. | Reserve Bank | Financial Agencies | Others |
| 1. Punjab Financial Corporation. | Feb. 1, 1958 | 2,00 | 1,00 | 30 | 20 | 40 | 10 |
| 2. Bombay State Financial Corporation. | Nov. 30, 1953 | 2,00 | 1,00 | 31 | 20 | 44 | 5 |
| 3. W. Bengal Financial Corporation. | March 1, 1954 | 2,00 | 1,00 | 30 | 20 | 40 | 10 |
| 4. Saurashtra Financial Corporation. | Sept. 29, 1953 | 2,00 | 1,00 | 26 | 10 | 54 | 10 |
| 5. Travancore-Cochin Financial Corporation. | Nov. 23, 1958 | 2,00 | 1,00 | 50 | 15 | 30 | 5 |
| 6. Hyderabad State Financial Corporation. | Feb. 13, 1954 | 2,00 | 1,00 | 50 | 10 | 35 | 5 |
| 7. Assam Financial Corporation. | April, 1954 | 2,00 | 1,00 | 50 | 15 | 30 | 5 |
| 8. U. P. Financial Corporation. | Aug., 1954 | 3,00 | 50, | 18 | 7.5 | 19.5 | 5 |
| 9. Bihar Financial Corporation. | Nov., 1954 | 2,00 | 50, | 20 | 7.5 | 17.5 | 5 |
| 10. Rajasthan Financial Corporation. | Jan., 1955 | 2,00 | 1,00 | 36 | 15 | 44 | 5 |

[Source : Reserve Bank of India, Annual Reports on Currency and Finance for 1953-54 and 1954-55.]

Under its bye-laws, the Madras Industrial Investment Corporation has restricted aid to industries organised on a joint-stock basis and with a minimum paid-up capital of Rs. 2 lacs. An exception has been made in the case of private limited companies for which no minimum capital has been prescribed.⁶ The minimum size of a loan has been fixed at Rs. 50,000.⁷ The usual period of loans varies from 12 to 15 years. The Corporation finances chiefly the acquisition of fixed assets, but in exceptional cases also lends, like the I.F.C. of India, short-term working funds to new industries. The advances are made up to 50% of the value of the fixed assets.⁸

In the first two years of its operation the Madras I.I.C. lent Rs. 62,20,000, out of which nearly 50% went to the share of the textile industry.* During 1953-54, the Punjab Corporation sanctioned loans amounting to Rs. 28.52 lacs and had disbursed a total amount of Rs. 8.84 lacs as on March 31, 1954.⁹

An Appraisal

At the very beginning of this critical examination it would be useful to point out that the system of State Financial Corporations has *not* been intended to finance cottage industry. The machinery of direct departmental financing under the State Aid to Industries Acts and

⁶ Resolution No. 8 of the Bd. of Madras I.I.C., dated 22-12-1949.

⁷ Bye-law No. 4, passed on 7-9-1949.

⁸ *Vide*, the Annual Reports of the Madras I.I.C.

* In 1953-54 it sanctioned loans worth Rs. 51.45 lacs.

⁹ Reserve Bank's Annual Report on Currency & Finance for 1953-54.

Rules will continue to accommodate cottage enterprises as in the past. The new machinery has supplemented the old by taking upon itself a substantial part of the other's financial burdens arising out of the business of helping inter-mediate and small-scale, over and above, cottage industries. Those exponents of cottage enterprise who expected much to come out of the creation of regional I.F.C.'s have, no doubt, been considerably disappointed. From their angle, the new Corporations are by no means an improvement upon the pre-war U.P. Industrial Finance Corporation or the Bengal Industrial Credit Syndicate, both of which were brought into being primarily with a view to easing the financial hardships of handicrafts. The absence of specialised bodies to undertake the financing of cottage industry represents an important gap in the government industrial financing system in the States.†

Of course, the enabling legislation of 1951 does not expressly debar the new Corporations from helping artisans, just as the I.F.C. of India Act does not explicitly prevent the I.F.C. from financing small businesses provided they are organised on a co-operative basis. This factor has, indeed, imparted some amount of flexibility to both the Central I.F.C. and the State I.F.C.'s. But it also implies that, at least in law, some overlapping of functions has occurred between the three major wheels of the State financing machine, namely, the I.F.C. of India, the system of the State Financial Corporations, and the mechanism of the State Aid to

† There is, of course, an all-India agency, namely, the National Small Industries Corporation 1955.

Industries Acts and Rules. In fact, a large number of concerns were found eligible to seek aid from two levels at one and the same time, and a few from all the three levels simultaneously. The tendency of the Madras L.I.C. to concentrate upon relatively safe and large enterprises yielded the worst consequence of such overlapping, namely, the financial starvation of under-capitalised small business. There were no definite rules and conventions to demarcate the sphere of each unambiguously from that of the rest. In order to put an end to this state of affairs a conference of representatives of the State Financial Corporations was held under the auspices of the Reserve Bank in August, 1954, and it was agreed that applicants for loans upto (1) Rs. 10 lacs or (2) 10 % of the paid-up capital of the corporations, if that was lower than (1), should be advised to apply to the State Financial Corporations.*

The State Financial Corporations are comparable in some respects with some of the State Banks of Australia, e.g., the Rural Bank of New South Wales, and the Rural and Industries Bank of Western Australia. In either country, the institutions have been designed to aid small business and work on a regional basis. Like an Indian State I.F.C., the Rural Bank of N.S.W. has its shares and debentures guaranteed by the State Government, and is empowered to accept deposits from the public to supplement its resources. The Rural and Industries Bank of Western Australia is also modelled very much on the same pattern. As in India, these

* Source : Reserve Bank's Annual Report on Currency and Finance, 1954-55, p. 49.

Australian Banks grant both short and long-term loans, but do not undertake direct or permanent participation in the share capital of private industry. But the points of dissimilarity between the systems in the two countries are more remarkable and fundamental. First, these two Australian State Banks finance not only industry but also agriculture and house construction, and for these purposes they work through separate Departments. Their field of operation is, thus, much wider than that of our Financial Corporations. Really, the truth is that industrial financing is not considered the most important objective by these State Banks. They have been designed primarily to function as agricultural banks. Secondly, while in Australia the emphasis is upon the lower stratum of small business, i.e. cottage industry, in India handicrafts have been left out of the scope of the State Financial Corporations. Finally, unlike the State Corporations, a few of the Australian Banks (e.g., the Rural Bank of N.S.W.) maintain their own economic research departments.¹⁰

There is so much common between the Central I.F.C. and a State I.F.C. that the latter can be described as virtually the I.F.C. of India writ small. The two systems practically differ in nothing except in their objectives. From the standpoint of financing techniques or of organisation or of methods of securing funds, there is no major difference between the two. Both are prevented from direct participation in ownership capital,

¹⁰ Source : Article by T. S. Rao in the Reserve Bank of Ind. Bull., August 1949 ; A. I. Qureshi, "State Banks for India" (1939).

and both are at present utilising only the loan method of assistance. Both are authorised to supplement their government-guaranteed share and debenture capital by accepting deposits from the public. Both are organised and managed in a more or less identical manner, and both lack departments of economic research.

Thus, both the I.F.C. of India and the State Financial Corporations have been invested with the same powers and subjected to the same limitations. But the present writer finds it very difficult to justify this. The identical-technique factor suggests that the quality of the financial needs of big and small business is on the whole identical, and that the difference, if any, is merely one of quantity. But nothing can be more misleading than such an assumption. Each State Financial Corporation should be free to develop new techniques with management adapted to the special conditions and requirements of small business in its own area. For this purpose alone an economic research department would become essential. There is no good reason why these Corporations should in practice do nothing better than making loans. As the Shroff Committee has rightly suggested, the Corporations should examine the question of guaranteeing long-term loans made by scheduled banks or insurance companies. The ban on share participation is both illogical and undesirable,—illogical because there is no valid ground on which a finance agency, after being empowered to underwrite shares, should be forbidden to subscribe to the same when underwriting, under the ruling market conditions, is nearly as risky as owning shares, as Dr. S. K. Basu of

the Calcutta University has aptly pointed out¹¹; undesirable because small and intermediate-scale jointstock concerns, even in advanced countries with well-organised finance markets, find it harder than their large counterparts to raise risk capital. We have discussed the special need for government agencies to provide risk capital, in addition to loan capital, in an under-developed economy like India in connection with our analysis of the Central I.F.C., and need not, therefore, amplify this point here over again. What we feel strongly to suggest in this place is that direct participation could be rendered less hazardous by means of various safeguards attached to the aid granted, control over the management of aided concerns to ensure the optimum utilisation of the outlay, joint participation in partnership with private financing agencies, aid to really desirable concerns on a selective basis, and improvement of the quality of small business management. The problem of small business management again brings us face to face with one serious lacuna in the organisation of these Financial Corporations, viz., the absence of technical investigation or research departments to furnish technological, commercial and entrepreneurial guidance to small firms.* While examining the case for such a department at the Central I.F.C., we came to the conclusion that necessary though it was, it could be dispensed with for the present. But the question of such a department for each State I.F.C., we feel, should

¹¹ *Vide* Basu, "The Role of State Financial Corporations in the Financing of Small and Medium-sized Industries", Calcutta University Commerce Magazine, 1951, p. 6.

* Also see S. K. Basu, *op. cit.*

be taken up without further loss of time, since one of the basic causes of the under-capitalisation, bankruptcy and failure of innumerable small firms in India, as elsewhere, is the poor and defective nature of their management.† True, big business in India also suffers from defective management, but in a much smaller degree. An American economist has aptly remarked, “financial aid to small business cannot be considered apart from the problems of raising the level of small business management.”¹² The proposed departments would be economical, too, in the long run. For by removing one after another some of the chronic managerial deficiencies of small industry, they would reduce its financial risks considerably, make it easier for it to raise long-term funds from non-government sources, and thus save the Financial Corporations substantial sums in future. The cost of maintaining such departments could be further reduced by enlarging the current sphere of the Corporations. In this connection it might be profitable to enable them to supply housing finance, over and above industrial finance, as in Australia, in order to supplement the inadequate system of co-operative housing agencies through which the bulk of normal-time State aid to private house building is disbursed in India. Another reform overdue is that, as the Shroff Committee has stressed, the State Financial Corporations Act, 1951, should be amended in a manner that would permit joint working of a Financial Corporation by two or more

† Recently, the International Planning Team, sponsored by the Ford Foundation, has also emphasised in its Report (submitted in 1954) the need for improved management and technology.

¹² Kaplan, “Small Business : Its Place and Problems” (1948), p. 177.

small, adjoining States who, by reason of their inadequate financial resources, might not be in a position to create and run individually separate Corporations.

Conclusion

The State Financial Corporations constitute undoubtedly a very useful addition to the structure of State-financing that is being built in the post-Independence era. But even after conceding all the bright implications of this plan for private industry, the necessity of introducing some vital changes into the structure, functions and techniques of these Corporations cannot be belittled. The adoption of the steps we have suggested is sure to render the State Financial Corporation System far more useful than it is to-day. It may appear that the newly-created National Small Industries Corporation (1955), in so far as it will work as an agency of research in management and production methods (which have a bearing on the financial problem), will largely reduce the need of special research departments as proposed by us. But will it be possible for this body alone to pay equal attention to the multiplicity of problems of small industries in different parts of our vast country? Not only each of our innumerable small industries has several complex problems, partly financial and partly non-financial, but the complex of problems for one and the same industry varies from region to region. Inevitably, the all-India Corporation will, at best, be an agency of co-ordination between the different institutions, including our proposed departments of research, which will be engaged in different types of research work for small industries' promotion in India.

CHAPTER VIII

POST-WAR FINANCING OF PRIVATE INDUSTRY BY GOVERNMENT DEPARTMENTS IN THE STATES

(I)

Except in the States where specialised financing agencies are at work, nearly the whole of the financial assistance forthcoming from the State Governments is given direct to private industry by their respective Departments of Industries (in some States designated as Departments of Industries and Commerce). A portion is disbursed by the Co-operative Departments, partly direct, partly through State Co-operative Banks. In comparison with the total financing done by Departments of Industries, the size of total aid to co-operative industry by Co-operative Departments is too small to deserve a detailed treatment in a general study like ours. Of course, there are marked inter-State differences in this respect. In some States (e.g. West Bengal), total aid to co-operative industry is not sizable at all. In some other States, e.g. Madras, Bombay, U.P., and Assam, sizable portions of total loans, grants and subsidies sanctioned by the Governments each year are earmarked for the benefit of co-operative effort in cottage and small-scale production. And viewing the country as a whole, the unmistakable trend of recent Government policy in respect of industrial financing has been to put increasing stress on the promotion of co-operative enterprise in cottage and small-scale industry.

(II)

So far as the beginnings of the system are concerned, loans to private industry are known to have been made in Baroda as early as 1891. The history of departmental financing in Mysore goes as far back as 1913. But these were rather exceptional cases, for not until the end of World War I did anything emerge in the nature of a common practice covering a large number of States. The 'twenties witnessed the real start, and the 'thirties a substantial spread, of the process of departmental financing in the States. By the time the Second World War broke out, the essential outlines of the system had been drawn distinctly and nearly completely and work in pursuance of them already begun, under specific State Aid to Industries Acts in some States and under departmental Rules and Regulations in others.

Pre-war and war-time experience under the State Aid to Industries Acts and Rules was not at all happy. The system was a failure in most States, especially where the State Aid to Industries legislation was at work. It fell into virtual disuse during the grim years of World War II. Not until the end of the War, but more correctly, not until the transfer of power in 1947 was the system subjected to revival and extension. The rehabilitation process has been carried to such an extent that post-war assistance to-day exceeds anything given during or before the War.

(III)

The evolution of the system of departmental financing has attained different stages in different States,

revealing noticeable divergencies not only in the size and terms, but in the very pattern, of aid given. In a few small and backward States, e.g. Coorg, Ajmere and Manipur, nothing by way of financial aid has been given.* Most of the remaining States do grant some sort of aid. But the components thereof differ so much in number and dimension from State to State that inter-State disparities become no less significant than inter-State similarities. There is, then, in a sense, not one complex system of financing by the State Departments of Industries, but rather as many separate systems as there are States which financially support private industry.

The causes of these inter-State differences may be traced to the following factors : inter-State disparities in the demand for financial aid from Governments, due chiefly to the different degrees of industrialisation reached by different States, on the one hand ; and on the other hand, inter-State divergences in the supply of assistance, owing to such forces as inter-State differences in income and budgetary strength, in financial legislation and rules, in administrative competence in the implementation of laws and rules, in enthusiasm in translating ideals of industrial uplift into practice, and to a degree, in constitutional status which have afforded

* Refers to the situation prevailing in 1952. This is true of nearly the whole chapter. But I believe that the arguments and conclusions of this chapter are quite valid and useful even to-day inasmuch as no remarkable new development has occurred in the sphere of departmental financing in the States during the period 1953-55.

greater scope of activity to some States (generally Part A States) than to others.

(IV)

A group of States, including Madras, Bihar, Orissa, Madhya Pradesh, W. Bengal, the Punjab (I), PEPSU and Mysore,* finances industry under specific State Aid to Industries Acts, others do the job under departmental Rules and Regulations. There is a good deal of divergence between the theoretical provisions of these Acts and Rules and the actual business done according to these provisions. A detailed and critical survey of the latter—the more important part of our task in this chapter—would be immensely facilitated if it is preceded by a comparative analysis of the former.

The most remarkable factor common to all these arrangements for financial assistance is their emphasis upon small and middle-sized industries. Of course, generally speaking, these Acts and Rules do not expressly exclude large enterprises. But the small size of the maximum aid permissible to a single party makes it impossible for big business to pin much hope to them. The machinery of the State Aid to Industries legislation, with the exception of that of the Punjab (I), attempts to weave a particular pattern of industrial growth by limiting support, as far as factory industry is concerned, to new or nascent industry and industry newly established in an under-developed area. Evidently, the pattern is one of decentralised and balanced industrial

* Only recently a State Aid to Industries Act has been promulgated in Mysore.

development. In this respect, the State Aid to Industries Acts bear close analogy with the Industries Assistance Act of Victoria, Australia, which authorises the Government of Victoria to finance the decentralisation of manufacturing industries.† The Punjab State Aid to Industries Act permits aid to industries requiring revival or development of modern methods, in addition to industries new or nascent and set up in undeveloped regions.

The financing technique common to the Acts and Rules of different States is the making of medium-to-long-term loans at favourable rates of interest. Another technique common to a large number of States is to give grants and subsidies. So far as other techniques are concerned, not every State system possesses the same items. The various Aid Acts, however, exhibit in this respect the maximum points of similarity. The Acts of Madras, W. Bengal, Bihar, Orissa and M.P. authorise the following methods of aid besides loans : (1) contribution to share and debenture capital, (2) guarantee of a minimum dividend on shares, (3) guarantee of cash credits or overdrafts or fixed advances with banks, and (4) incurring expenditure on training and research. The Punjab Act authorises only loans and subsidies. The Rules of several big States like Hyderabad, Bombay and Travancore-Cochin contain provisions for contribution to shares and debentures, guarantees and research outlay. In addition, the Acts and Rules of some States (e.g. Bihar, Orissa, W. Bengal and Bombay) contain

† U. N., "Economic Development in Selected Countries," Vol. II (1950), pp. 24-25.

such items as the supply of machinery on hire-purchase terms.

(V)

From what has been said above it becomes clear that the theoretical structure of departmental financing is far from uniform throughout India. What follows now is a detailed study of the facts and figures representing actual financial aid rendered by the State Governments to private industry under the aforementioned provisions since World War II (upto 1952).*

Bombay

Under the State Aid to Industries Rules, 1935, loans are granted to private concerns for starting new industries or developing the existing ones. According to information received in 1951, the Industries Department does not give any indirect aid in the form of guarantees. Free technical advice is, however, rendered. According to information published in 1954, the Government "has been following, for some years, a system under which it stands guarantee for the payment of the amount of margin, not exceeding 50 p.c., required by co-operative or other banks from industrial co-operative societies when advancing loans against pledge or hypothecation of raw materials, finished products or other assets." The figures of loans are given below.

* A large part of the statistics here given relates to the period ending with the financial year 1950-51, for these were collected at a time when the data of 1951-52 were not available to the State Govts. concerned. About Delhi, more recent information has been given.

| <i>Year</i> | <i>Applications sanctioned</i> | <i>Total Amount</i> |
|------------------------|--------------------------------|---------------------|
| 1945-46 | 5 | Rs. 12,000 |
| 1946-47 | 2 | 9,000 |
| 1947-48 | 16 | 186,400 |
| 1948-49 | 4 | 617,000 |
| 1949-50 | 8 | 535,800 |
| 1950-51 (upto Feb.) | 27 | 844,600 |

Interest Rate = $5\frac{1}{2}\%$ compound per annum. Maximum duration = 10 years.

[Source : Govt. of Bombay, Development Dept. Letters No. SAI—1151/20889—F of June 20, 1951 and SAI—1151/27803—F of July 13, 1951.]

In 1949, under a special Act of legislature, the Bombay Govt. guaranteed a 3% dividend p.a. for the first 5 years from the date of first allotment of shares of the Bagalkot Cement Co. Ltd.'s new issue. The Govt. was to share for 5 years in surplus profits, after a 6% dividend had been paid out, to the extent of 2.5% or $3\frac{1}{2}\%$ p.a. on the guaranteed amount, whichever was higher.¹

Madras

State aid is given in four different forms : loans, subscription to shares, guaranteed overdrafts and subsidies. Interest rate on loans is usually fixed at 5% p.a., and the maximum duration is 20 years. During 1945-50 overdrafts amounted to Rs. 1,04,000.† Loans, etc., were given as follows :

¹ Capital, January 12, 1950, p. 65.

† Director of Industry, W. Bengal, Letter No. 5569/1-M/3/52 of June 25, 1952.

| <i>Year</i> | <i>Loans</i> | <i>Subsidies (in Rs.)</i> | <i>Share Participation</i> |
|-------------|--------------|-------------------------------|--------------------------------|
| 1945-46 | nil | | 2,00,000 |
| 1946-47 | " | " | nil |
| 1947-48 | " | " | " |
| 1948-49 | 16,73,000 | 6,000 | " |
| 1949-50 | 19,52,900 | 2,000 | " |
| 1950-51 | 31,75,000 | 3,000 | " |
| 1951-52 | 10,74,000 | 5,000 | " |

(upto 9.6.1952)

[Source : Development Dept., Madras, Letters No. 61933-DII/52—1 of 9.6.1952 and No. 66362DII/52—1 of 18.6.1952).

According to information furnished by the Madras Director of Industries through the W. Bengal Director of Industries, Rs. 2,00,000 and Rs. 98,000 were sanctioned as loans during 1945-46 and 1947-48 respectively. According to the All India Rural Credit Survey (Vol. II, 1954), Madras disbursed Rs. 32.8 lacs as loans in 1950-51.

Bihar

| <i>Year</i> | <i>Grants</i> | <i>Loans (in Rs.)</i> |
|-------------|---------------|-----------------------|
| 1948-49 | nil | 500 |
| 1949-50 | 40,000 | 9,00,600 |
| 1950-51 | 2,840 | 3,84,930 |
| 1951-52 | 96,840 | 1,40,980 |

No loans given during 1945-48.

Interest Rate = 6½% for regular instalments and 8% for arrear instalments, 4% for those to Harijans and aboriginals.

All these loans and grants have been disbursed to cottage and small industries. No assistance by way of subsidies and share participation has so far been given to any industry. The duration of loans is usually 10 years, but can rise upto the statutory ceiling of 20 years with the special sanction of the Govt.

[Source : Letter from Additional Director of Industries, Bihar, No. 3027/C—4/C.I., dated 21-6-1952).
101.- 2/1952

Madhya Pradesh

From year 1945 onwards upto March, 1952 :

| Loans actually granted | Govt. investment |
|------------------------|-------------------|
| Rs. 3,17,79,202/2/8 | Rs. 1,17,11,000/- |

The maximum duration is generally 20 years, and the interest rate cannot be less than $\frac{1}{2}\%$ above Govt. borrowing rate. No grants and subsidies were granted. In only one instance, the Govt. had underwritten the share capital of a company.

[Source : M.P. Director of Industries, Letter No. 2080/CA of 14-4-1952].

Assam

No financial aid has been given to major large-scale industries.² Cottage industries have been financed by loans, grants, subsidies and 'contributions,' of which data are given below :

| Year | Loans | Subsidies | Grants (in Rs.) |
|---------|--------|-----------|--------------------|
| 1945-46 | 300 | --- | — |
| 1946-47 | 2,800 | --- | — |
| 1947-48 | 5,000 | — | 18,450 |
| 1948-49 | 33,400 | 5,962/8 | 26,825 |
| 1949-50 | 14,500 | 3,743/- | 16,509 |
| 1950-51 | 22,000 | 2,985/4 | 6,566 |

Only in 1950-51 contributions worth Rs. 2000 were sanctioned.

[Source : Directorate of Cottage Industries, Assam, Letters No. IG. 38/51/18 and No. IG. 38/51/23.]

² Directorate of Major Industries & Commerce, Assam, Letter No. DLI.95/51/67, dated 11-7-1951.

West Bengal

Aid is given under the State Aid to Industries Act. Upto 1951-52 (June), 120 units (90 cottage units + 27 small units + 3 medium-sized units) received Rs. 8.02 lacs as loans. The interest rate is 8%, reducible to 6¼% on regular payments. The maximum duration of loans is 12 years. Total share participation amounted to Rs. 70,000.³ Expenditures are also incurred for technical training and assistance.

Orissa

The following types of aid had been given to private industry from 1945-46 upto 1951-52: (a) Loans—Rs. 93,08,500, (b) Investment in share capital—Rs. 54,84,500, (c) Subsidies—Rs. 24,611. Rate of interest usually charged = 4% for ordinary instalments and 6% for arrear ones. Maximum duration of loans = 10 years. Considerable sums are spent on technical training and guidance, particularly for cottage industry.

[Source : Director of Industries, Letter No. 11664/Ind., dated 9.10.1952.]

Uttar Pradesh

The U.P. Directorate of Industries does not give aid to non-cottage or large-scale industries, according to information received in 1951.⁴ Loans and grants have been made to artisans.

³ Report of the W. Bengal State Financial Corporation Committee.

⁴ Directorate of Industries, W. Bengal, Memo. No. ⁸⁷¹⁵IM(9)/51 dated 29-8-1951.

| <i>Year</i> | <i>Allotted Loans</i> | <i>Allotted Grants</i> | } Source: "Loans and Grants Scheme", supplied by the U.P. Director of Industries, C. I. Section in 1951. |
|-------------|-------------------------|------------------------|--|
| 1947-48 | Rs. 150,000 | Rs. 100,000 | |
| 1948-49 | " 300,000 | " 300,000 | |
| 1949-50 | " 300,000 | " 300,000 | |
| | <i>Amount disbursed</i> | | |
| 1950-51 | Rs. 290,000 | — . | |

[Source : All India Rural Credit Survey, Vol. II, p. 118.]
Both in the case of loans and grants preference is given to co-operatives.

The Punjab (I)

| <i>Year</i> | <i>Cottage & Small-Scale Industry</i> | <i>Large-scale Industry</i> |
|------------------|---|-----------------------------|
| <i>Loans</i> | Rs. | Rs. |
| 1948-49 | 52,000 | 2,00,000 |
| 1949-50 | 1,01,950 | 2,50,000 |
| 1950-51 | 1,11,900 | 1,83,000 |
| <i>Subsidies</i> | | |
| 1948-49 | 52,765 | 36,600 |
| 1949-50 | 62,650 | 11,656 |
| 1950-51 | 23,300 | 10,000 |

Interest rate = $4\frac{1}{4}\%$ p.a. Period of loans = usually 7 years.

The State Govt. had not, uptill 1951, participated in shares of private industries. Information about pre-partition aid is not available with the Punjab (I) Government.⁵

Hyderabad

Loans advanced (direct as well as through the Industrial Trust Fund) to industries upto March 1950

⁵ The Punjab (I) Director of Industries, Memo. No. L/4/11/18211 and Memo. No. L/4/11/20265, dated 26.7.1951 and 20.8.1951 respectively.

amounted to Rs. 4.54 crores. Investments in shares of private industries stood at Rs. 8 crores in April, 1951.

[Source : Hyderabad Government Bulletin on Econ. Affairs, Jan.-March, 1950, p. 100 ; Capital, April 26, 1951, p. 589.]

Mysore

Assistance has been given under the Industrial Loan Rules and under the scheme of "Financial Assistance to the Educated Unemployed Persons to Start Industries of Their own." In May, 1951, government investment in the shares of private joint-stock companies stood at Rs. 83.54 lacs.* Rs. 70,22,429 were granted as loans from 1.7.1947 upto 31.3.1952. The maximum duration of loans is 10 years. The interest rate is 4% p.a. on small loans and 5% on heavy loans. At present aid is given under the State Aid to Industries Act.

[Source : Directorate of Industries & Commerce, Mysore, Letter No. E.I.L.A. Misc/52-53, dated 18.10.1952.]

Travancore-Cochin

The govt. helps both large and cottage industries. Figures of loans sanctioned through the Industries Dept. follow below :

| | <i>(Rs. in lacs)</i> | | | |
|---------|----------------------|----|----|------|
| 1945-46 | .. | .. | .. | 0'22 |
| 1946-47 | .. | .. | .. | 0'08 |
| 1947-48 | .. | .. | .. | 0'11 |
| 1948-49 | .. | .. | .. | 5'45 |
| 1949-50 | .. | .. | .. | 3'31 |

[Source : The Shroff Committee Report, 1954, p. 144.]

Long-term loans are also given by the Travancore Credit Bank. The Government has also participated in the shares of the following concerns:^a

* Eastern Economist, May 25, 1951.

^a Position in Nov., 1950.

| | | |
|-----------|---------|-----------------------------------|
| Rs. 217'5 | laks in | Fertilisers & Chemicals Ltd. |
| „ 30 | „ „ | Travancore Rayons Ltd. |
| „ 2'42 | „ „ | a glass company. |
| „ 2 | „ „ | Pulalur Paper Mills Ltd. |
| „ 2 | „ „ | Aluminium Industries Ltd. |
| „ 5 | „ „ | West Coast Fisheries Ltd. |
| „ 16 | „ „ | a cement company. |
| „ 15'20 | „ „ | Indian Aluminium Co. Ltd. |
| „ 2 | „ „ | Travancore Titanium Products Ltd. |
| „ 1 | lak „ | Vijay Mohini Mills Ltd. |

[Source : Travancore-Cochin News, Nov. 1, 1950.]

Saurashtra

Upto June 1951, the Government had advanced loans to the extent of Rs. 42,61,000, partly direct and partly through the State Bank of Saurashtra. In addition to this, the Government had purchased shares of certain undertakings. The interest rate on loans given through the State Bank is 5% or 2% above the Bank Rate, whichever is higher. State Bank loans are guaranteed by the Government.

[Source : Finance Dept., Saurashtra, Letter No. $\frac{42}{48}$
3707
dated 2.6.1951.]

Himachal Pradesh

In September, 1951, the total amount invested in private industrial concerns was about Rs. 9,71,250. No other type of direct financial aid had been rendered upto that period. Facilities for training are regularly given.

[Source : Director of Industries, H. P., Letter No. I & S. 53—59/51, dated 21.9.1951.]

Delhi

Since 1952-53 the State Government has started giving financial aid to cottage and small-scale industries

under the State Aid to Industries (Centrally Administered Areas) Model Rules, 1949. Upto 1953-54, about 100 small concerns, including several co-operatives, were advanced Rs. 4,84,400 by way of loans and subsidies.

[Source : Statesman (Cal.), Feb. 5, 1955, supplement page III.]

Patiala & East Punjab States Union

During 1951-52, Rs. 1,95,000 were disbursed among industries as loans, carrying 4% p.a.

[Source : PEPSU Directorate of Industries, Letter dated 23.4.1952.]

Coorg

According to information received in January, 1952, the Government has not given any financial aid to private industries.

[Source : Treasury office, Letter Dis. No. 295.]

Ajmere

According to information received in January, 1952, no provision exists for the grant of loans to major industries, while the rules for the grant of loans to small industries are under the consideration of the Government.

[Source : Director of Industries, Ajmere, Letter No. 541, of 15.3.1952.]

Manipur

According to information received in May, 1951, no financial assistance used to be given by the late Government of His Highness the Maharaja to private enter-

prise. The State was integrated with the Centre in October, 1949, and no such aid has as yet been given.

[Source : Revenue & Finance Dept., Manipur, Letter No. FB/5951/2, dated 12.5.1951.]

(VI)

It can now be seen that in a large number of States there exists a gap between theory, as embodied in the provisions of Acts and Rules, and practice. Another fact is that except outlays on training facilities and loans, there is no other technique of financing which has been commonly employed by all those States which pretend to have contributed something noteworthy by way of financial support to private industry. Next to outlay on training and loans, subsidies constitute the only other item to be found in the working structure of aid of the largest number of States. In respect of capital participation, the longest route has been traversed by Hyderabad. We might also mention Travancore-Cochin, Mysore and M. P. in this connection. The terms and conditions attached to various categories of aid have varied remarkably from State to State. What has not varied so much is the stress on small industry. In this respect the States have displayed an admirable identity with what may be characterised as a world trend to uphold small business.

(VII)

Whatever the reasons, the experience of departmental financing in the States has not been impressive

from any standpoint whatsoever : of volume, or of price, or of conditions, or of administration of assistance rendered. The sum total of loans and share-capital contributions by all the State Governments taken together amounted to Rs. 30 crores in 1951.* This represented only a small fraction of the present, not to speak of the prospective, needs of the cottage, small and medium-scale industries of the Indian States. And worse still, more than half of this meagre total was accounted for by only two States, viz., Hyderabad and Travancore-Cochin, while total loans and share contributions granted in W. Bengal did not exceed even Rs. 10 lacs ! The striking differences between the States in respect of the volume, terms, costs, and types of assistance are not warranted even by the inter-State differences in the conditions of demand and supply. These disparities have adversely affected the interest of balanced regional development of industries. With a few exceptions, interest rates may justly be considered as fairly high. Conditions of aid are unduly rigid, especially those laid down in the State Aid to Industries Acts.** The administration of aid has also been defective.† Taking everything into account, our conclusion is that, leaving aside Hyderabad, Travancore-Cochin, and to some extent, Mysore, where some solid work has been done, no other State in India can be said to have

* Capital, May 10, 1951, p. 661.

** Also see, Basu, "Industrial Finance in India" (1950 ed.), ch. vii, and Report of the West Bengal State Financial Corporation Com., ch. v.

† I refer, in this connection, to the financing of industry by more than one Department in several States.

achieved anything substantial or remarkable in connection with the financing of private industry. The only

More up-to-date information concerning total aid follows below :

Aid to Industries by Part 'A' States (in laks of Rs.)

| | 1951-52 (Accounts) | 1952-53 (R. E.) | 1953-54 (B. E.) |
|---------------------------|-----------------------|--------------------|--------------------|
| (1) Investments in shares | 128 | 186 | 210 |
| (2) Loans | 156 | 280 | 266 |
| (3) Grants | 6 | 30 | 22 |

Notes : (1) Includes those by Madras Industrial Investment Corporation, Co-operative Banks, etc.

Aid given by Part 'B' States (in laks of Rs.)

| | 1951-52 (Accounts) | 1952-53 (R. E.) | 1953-54 (B. E.) |
|---------------------------|-----------------------|--------------------|--------------------|
| (1) Investments in shares | 530 | 26 | 157 |
| (2) Loans | 77 | 90 | 42 |
| (3) Grants | - | 2 | -- |

Note : (1) Includes State I.F.C.'s, Co-operative Banks, etc.

[Source : The Shroff Committee Report, 1954.]

encouraging sign is that there is a general trend towards increasing budget provisions by these Governments for the purpose of industrial finance. The centre has recently asked the States to liberalise the rules and procedure regarding grants of loans to small industries. It has further promised to meet a portion of the loss that may be incurred by the States as a result of this liberalisation.

(VIII)

The inadequacy of total financial aid variously given to private industries so far through the Departments of Industries establishes a strong case for an enlargement of that assistance by such devices as the

liberalisation of the relevant Acts and Rules in necessary cases and larger budgetary provisions for industries. But does this necessarily make an equally strong case for larger operations by these Departments? The answer depends upon a satisfactory and final solution of the departmental financing versus institutional financing issue.

There is virtually a universal unanimity of expert opinion in India on the desirability of channelling monetary help, now being given by Departments, through suitable specialised institutions. Beginning with the Industrial Commission (1916-18) right into our own times, several authorities have expressed themselves in favour of special, independent agencies. They dwelt, in the main, on the incompetence of Govt. Departments. But, although all agree that a Department is not fit to finance industry, there is no general agreement on two fundamental questions: should the transfer of functions from a Department to a special agency be partial or complete, and what is going to be the organisational character of that special agency? Regarding the first issue, whilst the trend of majority opinion has been to stress a more or less complete transference, actual Government policy has favoured partial transference—the creation of supplementary finance corporations for small and middle-sized factory industries and the retention of departmental aid for smaller and cottage enterprises. On the second question, a large section of opinion represented by the co-operative school of thought has preferred co-operative industrial banks to ordinary financial corporations. But this debate is really appli-

cable to the case of non-factory industry only, for factory industry is rarely organised and operated on co-operative principles in India. Accepting current Government policy, the real tussle clearly lies between the retention of departmental aid and the creation of co-operative banks. The W. Bengal State Financial Corporation Committee had suggested that there would remain no scope for conflicts, and that all the three agencies—a Department of Industry, a State-aided co-operative bank, and a State I.F.C. with government participation—would be able to operate simultaneously without friction in view of the considerable field each would get even after a clear-cut demarcation of jurisdictions. The personal view of the present writer is that whatever the organisational character of the proposed special body, the transfer of functions to it should be complete. At the same time he confesses that he has no faith in the theory that co-operative institutions ought to be set up and run under all circumstances and at all costs.

CHAPTER IX

FINANCING BY THE RESERVE BANK OF INDIA

In countries like the U.S.A. and the U.K., the central bank is generally acclaimed as one of the most important agencies through which government financial aid is extended to private enterprise. Central banking practice in this connection has, however, varied from country to country. For instance, in contrast with the American central banking system, the central bank of the U.K. has played no direct role in industrial or agricultural financing. Following the Bank of England, the Reserve Bank of India (nationalised in 1949) has taken no part in the direct financing of private industry or agriculture.

The Reserve Bank of India Act, 1934, which created the Reserve Bank of India, did not postulate the provision of industrial finance as an important or desirable function of the Reserve Bank. It gave the Bank no power to finance industry direct on a short or long-term basis. During World War II the Reserve Bank, it is understood, was authorised to finance scheduled banks desirous of assisting war contractors or other government suppliers. But such assistance was of an extremely short-term character. Its actual volume has never been precisely known.¹ In the post-war period the Bank has actively co-operated in the establishment of the Industrial Finance Corporation of India and contributed to its share-capital and bonds. The amendment of the

¹ S. K. Basu, "Industrial Credit in War and Post-war Economy" (1945), p. 34.

Industrial Finance Corporation Act in 1952 authorised the Corporation to borrow funds from the Bank against specified types of securities. It further provided for the creation of a Special Reserve Fund to which dividends on the shares held by the Central Govt. and the Reserve Bank would be credited until the amount in the Fund exceeded Rs. 50 lacs. Empowered by the State Financial Corporations Act, 1951, the Bank has contributed Rs. 95 lacs towards the share capital of the Industrial Finance Corporations in the States.² This round-about method of financing industry has been practised by the Bank of England for a long time. In the inter-war period it sponsored the creation of several capital lending institutions and participated in their resources as well; of these, the Securities Management Trust, the Bankers' Industrial Development Company, and the United Dominions Trust were the most noteworthy. After the Second World War it has again participated in the setting up of two now-familiar finance agencies, viz., the Finance Corporation for Industry, and the Industrial and Commercial Finance Corporation.

In agricultural finance this indirect method of Bank of England assistance has consisted in the Bank's contribution to the ownership capital of the Agricultural Mortgage Corporation of England (1928). There is no such farm financing agency in India, and the Reserve Bank has not subscribed to the shares of any financial

² Source : Reserve Bank of India Bulletin, August 1954, p. 745.

The fact that the Reserve Bank is a shareholder of the State Bank of India, successor to the Imperial Bank, may also be considered in this connection.

institution having direct contact with the cultivator on a large-scale. But agricultural financing is a special mission of the Reserve Bank, and the Bank is now an important shareholder of the newly set up State Bank of India (1955) which is expected to play a considerable part in the development of farm credit. It has a special Agricultural Credit Department, and makes available to agriculturists short and medium-term credit through the State Co-operative Banks and long-term credit through the Central Land Mortgage Banks. For facilitating these operations the Bank has now set up two special Funds, namely, the National Agricultural Credit (Stabilisation) Fund and the National Agricultural Credit (Long-Term Operations) Fund. The Bank further possesses a Department of Banking Development (1950). Some of the duties of this Department are the removal of impediments in the way of commercial bank expansion in rural areas, improvement of the rural financing machinery in connection with both the mobilisation of rural savings and the extension of rural credit, and the development of ware-housing. In view of the predominating position of agriculture in the Indian economy, it is necessary to analyse the agricultural financing business of the Reserve Bank in some more details.

Financing Agriculture

Section 54 of the Reserve Bank of India Act, 1934, empowered the Bank to run a special Agricultural Credit Department. The statutory functions of this Deptt. are : (i) to keep an expert staff to study all questions of farm credit and to be available for consultation by the

Government of India, the State Governments, State Co-operative Banks and other Banks ; and (ii) to co-ordinate the operations of the Bank in connection with agricultural credit and its relations with the State Co-operative Banks and any other banks and organisations engaged in agricultural financing. Under sub-sections 2(b), 4(a), 4(c) and 4(d) of Section 17 of the the original Act, the Bank could grant the following aid to agriculture :—

1. Loans and advances against Government paper for 90 days to State Co-operative Banks, and through them to co-operative central banks and primary land mortgage banks.

2. Similar loans and advances to State Co-operative Banks and central land mortgage banks declared to be State Co-operative Banks, and through them to co-operative central banks and primary land banks against approved debentures of recognised land-mortgage banks which were declared trustee securities and which were readily marketable.

3. Advances to State Co-operative Banks for 90 days against promissory notes of central co-operative banks drawn for financing seasonal agricultural operations, or rediscount of such promissory notes maturing within 9 months.

4. Loans for terms not exceeding 90 days to State approved co-operative marketing or ware-housing societies endorsed by State Co-operative Banks and drawn for the marketing of crops, or rediscount of such promissory notes maturing within 9 months, or loans

and advances on the promissory notes of State Co-operative Banks supported by ware-house receipts or pledge of goods against which a cash credit or overdraft had been granted by the State Co-operative Bank to marketing or ware-housing societies.

The Reserve Bank of India (Amendment) Act, 1951, however, changed the maximum, accommodation period of 9 months to one of 15 months by altering sub-clause (b) of clause 2 of Section 17 of the Act of 1934. The Select Committee, appointed to report on the amendment Bill, pointed out that although 12 months might normally suffice for financing seasonal operations, some crops, such as sugarcane, took a longer time to mature and market. The quality of Reserve Bank assistance, as evident from these statutory provisions, could be summed up in the following words. It was, first of all, short-term. Secondly, it was indirect. And finally, even within the sphere of short-dated credit this aid was limited to specific purposes. It was available only for seasonal operations and marketing of agricultural crops. Further, 'agricultural crops' excluded such commodities produced by the ryot as milk, cream, butter, ghee and wool. But, another amendment of the Reserve Bank of India Act in 1953 widened the scope of the expressions 'crops', 'agricultural operations' and 'marketing of crops' so that finance might also be made available for production and marketing of commodities such as gur, milk, ghee, etc., and also for processing of goods where such processing was a necessary preliminary to marketing. The 1953 amendment also enabled the Reserve Bank to dispense

medium-term farm credit for periods ranging more than 15 months but not exceeding 5 years subject to a Government guarantee of such advances. A limit of Rs. 5 crores was fixed in respect of such advances.

Necessary steps to give effect to the provisions of the original Act and its amendment in 1951 have already been taken. Financial accommodation to the co-operative movement is being granted by the Bank through apex co-operative institutions at a concessional rate of 1½% (since 1946). Until recently, however, this facility was not used extensively by the co-operative banks for various reasons. Consequent upon the recommendations of the Informal Conference on Rural Finance in February 1951, various procedural reforms were effected which have not only increased the borrowings by co-operative banks but have also enabled them to frame their borrowing and lending plans according to local needs and conditions. The following table gives the actual figures of loans and advances granted so far.

| | | | | | | | |
|---------|-----|-----|------|---------|-----|------|------|
| 1946-47 | Rs. | 1'5 | laks | 1950-51 | Rs. | 762 | laks |
| 1947-48 | " | 17 | " | 1951-52 | " | 1240 | " |
| 1948-49 | " | 103 | " | 1952-53 | " | 1242 | " |
| 1949-50 | " | 214 | " | 1953-54 | " | 1632 | " |

[Source : Reserve Bank of Ind. Bull., Sept. 1951, August 1952, and August 1954.]

Of course, in the field of long-term credit the Reserve Bank has not remained quite inactive. Technical aid and advice on the issue and redemption of debentures of the central land mortgage banks are available from the Bank. In 1948 the Bank undertook to contribute up to 10% of such debentures provided they were guaranteed by the Government in respect of principal

and interest. The percentage was raised to 20 in 1950. Further changes occurred in 1953. The Central Government has now set apart Rs. 1 crore out of the allotment of Rs. 5 crores for long-term agricultural credit under the First Five Year Plan for the purchase of debentures issued by land mortgage banks. In this connection, the Reserve Bank, in consultation with the Government of India, has agreed upon a scheme of joint contribution to such debentures up to 40% of the issue or the short-fall in public subscription whichever was less, one-half of the subscription being on behalf of the Government and the other half by the Reserve Bank. According to information received in 1954, only the Andhra Land Mortgage Bank has so far been accommodated under this scheme to the tune of Rs. 17 lacs. Figures of contributions to land bank debentures by the Reserve Bank are given below³ :—

(in lacs of Rs.)

| Year | Amount |
|---------|----------|
| 1949-50 | .. 4'15 |
| 1950-51 | .. 20'00 |
| 1951-52 | .. 13'00 |
| 1952-53 | .. 16'89 |
| 1953-54 | .. 15'56 |

Besides giving financial assistance to the co-operative credit movement the Bank has taken in recent years an active part in the development of the movement itself. It has initiated plans for the reorganisation of the co-operative credit structure in the various States and the training of their co-operative personnel, is colla-

³ Reserve Bank of Ind. Bull., August 1954, p. 744.

borating with the State Governments in the re-organisation of co-operative credit which is taking place in several States, and has undertaken a scheme of voluntary inspection of co-operative banks. Acting on the recommendations of the Rural Banking Enquiry Committee (1950), the Bank has taken steps for the development of banking facilities in semi-urban and rural areas. In order to solve the vital question of formulating a long-term plan of rural finance in regard to both policy and organisation, the Central Board of the Reserve Bank decided to undertake an All India Rural Credit Survey in 1951 and accordingly constituted a Committee of Direction with A. D. Gorwala as its Chairman. The General Report of this Committee, published in late 1954, contains various suggestions for facilitating rural credit (for both agriculture and small industry), and emphasises in particular the need for increasing long, medium and short-term aid to the co-operative credit organisation. The Reserve Bank of India (Amendment) Act, 1955, provides, amongst other things, for the setting up by the Bank of (1) a National Agricultural Credit (Long-Term Operations) Fund and (2) a National Agricultural Credit (Stabilisation) Fund, as recommended by the Gorwala Committee. The National Agricultural Credit (Long-Term Operations) Fund will be utilised exclusively for granting loans and advances to State Governments for subscribing to the shares of co-operative credit societies, for making long-dated loans and advances to Central Land Mortgage Banks, and for making intermediate-term loans to State Co-operative Banks for agricultural purposes. To this Fund shall be credited an initial sum of Rs. 10 crores by

the Bank and such further sums of money as the Bank may contribute every year, provided that the annual contribution during each of the 5 years starting with the year ending on June 30, 1956, shall not be less than Rs. 5 crores, and provided further that the Central Government may authorise the Bank to raise or lower the amount of its annual contribution in any year. The other Fund will be used only for making medium-term loans and advances to State Co-operative Banks to enable them to convert short-term credit into medium-term credit, if necessary. To this Fund shall be credited such sums of money as the Bank may contribute every year, provided that, unless otherwise required by the Central Government, the annual contribution during each of the 5 years starting with the year ending on June 30, 1956, shall not be less than Rs. 1 crore. Due to the amendment of Section 17, after the words "State Co-operative Banks" the expression "State Financial Corporations....." shall be inserted [a new, but not very important, development in the sphere of industrial finance] in clause 4, in sub-clause (c), after the words "the Bank" the words "or as are fully guaranteed as to the repayment of the principal and payment of interest by a State Government" shall be inserted, and in sub-clause (d), for the words "a cash credit or over-draft granted" the words "a loan or advance made" shall be substituted, and clause 4(A) shall be replaced by "4(A) the making of loans and advances out of the National Agricultural Credit (Long-Term Operations) Fund and the National Agricultural Credit (Stabilisation) Fund established under Section 46A and Section 46B respectively.....".

An Appraisal of Agricultural Financing

It is undeniable that a change has occurred both in the Bank's conception of its role in rural credit and in its actual policies, as compared to the position up to, at any rate, 1947. While formerly the Bank used to lay down conditions which co-operative banks would have to fulfil before they could be eligible for obtaining financial accommodation, inclining to overlook at the same time the vital consideration that it could itself lend a helping hand in bringing about the rehabilitation it demanded, in recent years it has been giving new life and leadership to the co-operative credit movement. According to a foreign expert writing in 1954, "probably, no other central bank in the world is doing as much to help, develop and finance co-operative rural credit institutions." Shorn of its exaggeration, the statement is not altogether false. But despite the real change in the attitude of the Bank and its various efforts to bolster up co-operative credit, the fact remains that neither the advances made so far nor the effects of those advances have been substantial. During 1954 the co-operative credit organisation supplied only 3.1% of the total borrowings of cultivators.⁴ The private financier still dominates the scene. The insufficiency of the Bank's assistance and the failure of the Bank to link the money-lenders' organisation with its own are the two fundamental causes responsible for the ineffectiveness of the Bank's plan of cheaper credit inside the major part of the rural credit market. Lower interest-rates have not

⁴ Vide the "All-India Rural Credit Survey" (1954), Vol. II, p. 167.

spread to the main channels of the co-operative credit system. The recent attempt of the Bank to facilitate long-dated farm credit by subscribing to land bank debentures is doubtless worthy of praise. But it would have to explore other ways of assisting land mortgage banking (e.g. by contributing share capital in selected cases) if the latter is to work as a more useful source of long-term farm finance in India. By virtue of the recent amendments to the Reserve Bank of India Act, the Reserve Bank is certainly better equipped now to finance agriculture than at any previous time. In this connection it would be interesting for us to know the activities of some central banks abroad in respect of private business financing.

Foreign Experience

The Rural Credits Department (1925) of the Commonwealth Bank of Australia makes advances which are very short-term (cannot exceed 1 year) and cannot be given to the farmer direct. It is for all practical purposes a separate institution, having separate funds of its own contributed by the Commonwealth Bank and the Commonwealth Government. The Central Bank of Ceylon (1950) grants only short-period credit for marketing as well as production purposes. The Agricultural Credit Department (1933) of the Central Bank of Argentina makes loans to individual farmers as well as their co-operatives for various short and medium-term purposes (usually not exceeding 5 years). The Mortgage Branch (1926) of the Bank of New Zealand furnishes one of the earliest examples of central bank participation in direct and long-term agrarian financing. Another

example is provided by the Mortgage Bank Department (1943) of the Commonwealth Bank of Australia which makes long-dated loans for not less than 5 years and not more than 41 years, on the security of an estate or interest in land to any person engaged in farming or allied pursuits.⁵

Any discussion about central banking participation in industrial financing must open with the U.S. Federal Reserve System and the Commonwealth Bank of Australia. Under Section 13b of the Federal Reserve Act of 1913, if "in exceptional circumstances" an F. R. Bank finds that an "established industrial or commercial business" within its district cannot secure loan on a reasonable basis from the usual sources, it may (a) make loans to or (b) buy the obligations of that business, provided such loans and obligations have maturities not exceeding 5 years and are for working capital purposes, or (c) may participate up to 80% in any such loans and obligations with any finance agency in its district.⁶ The Industrial Finance Department of the Commonwealth Bank of Australia was set up in 1945. In contrast with Federal Reserve aid which is chiefly intermediate-term, financial aid by this Department is of a long-term character. The stress of both, however, is on small business whose financial hardship is the acutest in all countries. The following are some of the important

⁵ Sources : T. S. Rao, "Agricultural Finance in Australia", Reserve Bank of Ind. Bull., August 1949 ; U.N., "Economic Development in Selected Countries," Vol. I ; J. P. Niyogi, "Co-operative Movement in Bengal" (1940).

⁶ Fuller, "Government Financing of Private Enterprise" (1948), ch. vi.

methods of financial assistance open to the Industrial Finance Department : (i) over-drafts, (ii) hire-purchase finance, (iii) contribution to loan and share capital, and (iv) underwriting share issues.⁷ Perhaps no other central bank has taken a more direct and substantial part in industrial financing so far. The Commonwealth Bank provides, in addition, housing finance to individuals and building societies through its General Banking Department. Long and intermediate-term credit facilities are provided by the central banking system of West Germany for export industries. The Central Bank of the Philippines (1949) has also taken part in direct lending to private enterprises.⁸

Estimate of Some Old Proposals

Ever since the establishment of the Reserve Bank there has not been any scarcity of proposals for enabling the Bank to take a larger and more direct share in agricultural and industrial financing. The recent amendments of the Reserve Bank of India Act have rendered some of those proposals, and the criticisms relevant to those proposals, rather out-dated. But there are others which can claim consideration even to-day. In its Report (1950), the Indian Fiscal Commission of 1949-50 recommended the creation of a machinery akin to the Industrial Finance Department of the Commonwealth Bank of Australia. But as we already have an all-India I. F. C. for financing practically the same interests as the proposed Department of the Reserve Bank would assist,

⁷ Basu, "Financing Post-War Industry" (1938), ch. v.

⁸ U. N., "Economic Development in Selected Countries" Vol. II (1950), p. 172.

the suggestion is quite untenable. The utmost that can be done in this respect is that the I. F. C. of India can be changed by statute into a Department of the Reserve Bank on the Australian model. Although this Department will be, to all intents and purposes, a separate institution, still its incorporation with the central bank of the country will yield the major benefit of a planned co-ordination and integration of industrial financing policies with the general policy of monetary control, so essential in an economy like India lying under the shadow of inflation. A somewhat similar policy is being pursued in Argentina, an under-developed country of Latin America, where a Decree of 1946 has made the Industrial Credit Bank (1944) an integral part of the central banking system for the purpose of co-ordinating the former's activities with the economic, financial and social policy of the Government.⁹ From time to time proposals have been put forward for either creating a Department on the analogy of the Mortgage Bank Department of the Commonwealth Bank of Australia, or the Mortgage Branch of the Bank of New Zealand, or reorganising the Agricultural Credit Department in such a way that it can lend both short and long-term funds direct to the ryot as well as indirectly through other institutions.¹⁰ Long-term funds the Agricultural Credit

⁹ U. N., "Economic Development in Selected Countries", Vol. I.

¹⁰ 3rd Conference of the Indian Provincial Co-operative Banks in 1934; Sir M. B. Nanavati in "The Indian Rural Problem" (1947 ed.), Appendix; K. N. Raj, "The Monetary Policy of the Reserve Bank of India" (1948); K. K. Sharma, "Reserve Bank of India and Rural Credit" (1949); J. P. Niyogi, "The Co-operative Movement in Bengal" (1940), p. 140.

Department is now already furnishing through the Central Land Mortgage Banks. Before enabling it to participate in the direct financing of the peasantry as in the Anzac countries, we shall have to solve the problem of rendering Reserve Bank aid non-competitive with co-operative finance to whose promotion the State is now firmly committed for good or ill. This can be achieved if the Agricultural Credit Department works more or less as an 'apex' agency for both the short-term and long-term sectors of the co-operative credit organisation in areas where the co-operative movement has taken roots, and maintain direct relations with the peasantry in areas where co-operation is rather undeveloped. The Agricultural Credit Department will have to co-ordinate its activities constantly with those of the taccavi lending machinery which also deals direct with the ryot, so long as that machinery continues to function as an alternative source of farm credit.

Conclusion and Remarks

There is no universal rule of central banking. The central bank is nothing but an organ of the modern planning State. It has got to shape its policies and operations in accordance with the requirements of development. This is the criterion which will decide the role the central bank will be called upon to play in actual practice. On the basis of this criterion, in an under-developed economy with an inadequate market for loanable funds, the central bank is usually regarded as an agency, not only of regulation, but also of development, of that market so long as the latter is not in a position to meet the essential demands for financing

agricultural and industrial uplift.¹¹ Financial difficulties still constitute the major stumbling block in the way of progress in the private sector of business in India. The policy of the Reserve Bank appears to be one of taking an increasing but indirect part in the financing of private effort. But this policy has not uptill now yielded considerable results. The Bank will have to play a much larger part as a major source of industrial and agricultural credit if the problem of disequilibrium between demand and supply of loanable funds is to be successfully tackled. This has been rightly recognised by the Committee of Direction of the All India Rural Credit Survey which, in its General Report (Vol. II) published towards the end of 1954, has recommended that the present overall statutory limit of Rs. 5 crores on the medium-term loan operations of the Reserve Bank should be removed, and that the Bank should be statutorily empowered to make long-term loans to land mortgage banks. It has also recommended the establishment of a National Agricultural Credit (Stabilisation) Fund and a National Agricultural Credit (Long-Term Operations) Fund in the Reserve Bank. The Bank has been asked to contribute not less than Rs. 1 crore per annum to the first Fund and not less than Rs. 5 crores per annum to the second Fund. Out of the first medium-term loans would be given to State co-operative banks etc., in special circumstances, while out of the second long-term aid would be given to land mortgage banks. The National Agricultural Credit (Long-Term

¹¹ See S. N. Sen, "Central Banking in Undeveloped Money Markets" (1952).

Operations) Fund and the National Agricultural Credit (Stabilisation) Fund have already come into existence. As we have already mentioned, the Reserve Bank of India (Amendment) Act, 1955, contains provisions for the creation of two such Funds.

CHAPTER X

FINANCING AGRICULTURE

The beginning of government financial assistance to agriculture goes back to the last quarter of the 19th century. Rising rural indebtedness accompanied by an increasing pauperisation of the peasantry was assuming alarming proportions, and various schemes for organising agricultural banks or similar agencies were submitted to the Government of India. Instead of creating farm financing machinery on suggested lines, the Government, however, passed the Land Improvement Loans Act in 1883 and the Agriculturists' Loans Act in 1884. This was merely enabling legislation which empowered the State (then Provincial) Governments to advance long and short-term taccavi loans to farmers direct through appropriate departments and to frame their own rules about such loans. Thus, from the very outset, the Government sought to erect a decentralised financial organisation, naturally suitable for a vast country like India, with the regional Governments responsible for framing and carrying out their own respective policies within the broad limits set by the above two all-India Acts. The Government also sought to influence rural credit indirectly by two sets of legislative measures, namely, debt relief legislation and money-lending legislation, the contents and effects of which naturally have varied from State to State.

A. The Present Structure of Assistance

Under the L.I.L. Act of 1883, the State Governments can make long-dated loans to farmers direct for periods

rising upto 35 years. In practice, these loans have been restricted to 20 years, the minimum period being fixed at 5 years generally. The interest rate is determined in relation to the rate at which public loans are floated in the market. Under the A.L. Act of 1884, short-term loans are made available for the purchase of cattle, seeds, manure, implements and any other things not specified in the Act of 1883 but connected with agriculture. Loans are to be repaid usually at the next main harvest, or after two main harvests. In a number of States like U.P. and Madras, taccavi loans have also been granted for old debt redemption. Some States, notably the Punjab, have also given loans in kind for ensuring the maximum utilisation of funds.

An institutional approach to agricultural financing gradually came to be evolved in the first quarter of the 20th century when the Government began to seek an alternative solution to the problems of farm financing by sponsoring and supporting the organisation of co-operative credit. As in the case of the taccavi loans, the responsibility for carrying out the new policy was again ultimately entrusted to the State Governments.* Financial aid to the co-operative movement to-day takes the following forms: (a) financial commitments in maintaining special Co-operative Departments; (b) aid by way of loans, grants-in-aid, subsidies, guarantees of principal and interest of debentures issued by co-operative land mortgage banks, and participation in the share capital of several State Co-operative Banks and Central

* Till 1919, financing the co-operative movement was a Central responsibility.

Land Mortgage Banks ; (c) supply of expert personnel, entirely or partly free of charge, to various co-operative institutions which cannot otherwise afford to engage them ; (d) special concessions and privileges, e.g., exemption from income tax, stamp duty and registration fees, free remittance facilities, etc., and (e) expenditure in the cause of co-operative education which indirectly helps the co-operative movement.

During the 'thirties, the Reserve Bank of India, equipped with a special Agricultural Credit Department, was enrolled as an integral part of the system of government financing of private agriculture. Its assistance is indirectly given to agriculturists for short, long and medium-term purposes. The experience of Reserve Bank assistance has already been analysed in details in the preceding chapter.

Apart from these various types of assistance directly and indirectly extended to agriculture as a part of normal activity, additional government funds have been spent under the special Grow More Food Campaign which was launched in 1943 by the Central Government in order to meet the food shortage of the country. Its term was extended, through several changes, up to 1954. It was later on included in the First 5-Year Plan of the Government of India. Under the G. M. F. Campaign, financial aid to agriculturists by the State Governments has consisted of short and long-term loans and advances in cash as well as in kind, mostly interest-bearing, but sometimes interest-free for a part or the whole of the term and/or the sum lent, grants and subsidies, remission of or rebates on land revenue, supply of various

materials, capital goods and technical services at concessional or subsidised rates, free departmental supervision, service and advice, various facilities to secure land and other necessities of farm production, stimulus in the shape of prizes for best yields, contribution to the share capital of co-operative farming societies and giving guarantee of the margin of losses to co-operative financing agencies (e.g. in Bombay). G. M. F. loans are primarily given under the L. I. L. Act and the A. I. Act,¹ but their terms and prices differ from—are usually better than—those of loans normally given under the two Acts. The general principle regarding grants is that in private schemes of food production the farmer concerned must bear at least 50% of the total outlay. The general policy of loans is to give them, as far as practicable, for such schemes as can pay for themselves. Subsidies are granted only where the scheme in question is not sufficiently productive or where the farmer is not familiar with a particular practice (e.g. green manuring, composting).² Apart from minor inter-State variations in programmes, States' activities follow a nearly identical pattern, to be explained perhaps by the fact that the fundamental problems and difficulties of the ryot are approximately the same throughout India.

A recent development "which merits attention is the inclusion of agricultural finance in the various forms

¹ Directorate of Economics and Statistics, Ministry of Food and Agriculture, Govt. of India, Memo. No. 1990/51—FP. ES., dated 17.1.1952.

² Source : "Towards Self-Sufficiency" (1951), kindly supplied by the Economic and Statistical Adviser (Dr. Sen) of the Govt. of India.

of assistance given under a number of schemes in different States for the rehabilitation of displaced persons" ; this form of aid is specially important in the Punjab (I), W. Bengal and Assam.

The latest development in the field of agricultural finance is the creation of the State Bank of India in July, 1955, by the Government of India on the recommendations of the Gorwala Committee. The State Bank of India Act, 1955, which constitutes the State Bank, provides for transfer to it on July 1, 1955, the Imperial Bank of India with all its assets and liabilities. Its authorised capital is Rs. 20 crores. For the present it will primarily function as a commercial banking institution. But as a strong, integrated, national institution, it would gradually be able to provide vastly extended remittance facilities for co-operative and other banks, and thus stimulate the further development of these banks. Moreover, in its loan operations in so far these have a bearing on rural finance, the State Bank would follow a policy which, while not deviating from the canons of sound banking, would pay due regard to public interests. The Act requires the State Bank to open not less than 400 branches within 5 years according to an expansion programme to be approved by the Central Government. In order to meet losses that may be incurred by the Bank by its having to open unremunerative branches in the national interest, the Act constitutes an "Integration and Development Fund". The Act also provides a summary procedure for voluntary amalgamation of any bank with the State Bank (in particular, a State-associated bank, e.g., the Bank of Mysore).

The structure of government financing of private agriculture is, thus, made up chiefly of the following components : (1) taccavi loans given as a normal activity under the L.I.L. Act and the A.L. Act, plus loans given under some individual schemes in a number of States, (2) aid under the special G.M.F. Campaign, (3) financial accommodation made available by the Reserve Bank of India, (4) financial accommodation going to be made available by the newly started State Bank of India, (5) financial support to the co-operative movement [a part of this item is, however, covered by items (2), (3), and (4)], and (6) aid to facilitate the resettlement of refugees on land. Items (1), (2) and (6) cover the bulk of all financial aid, and most of each is supplied direct to ryots by the government departments concerned. The pursuit of this direct departmental approach is the predominant characteristic of State assistance to agriculture in most of the economies of South and South-East Asia, in contrast with developed Western economies (like the U.S.A.) where State aid is largely distributed through government and/or government-sponsored private financial institutions. The under-developed state of governmental agencies specialising in long-dated credit is an outstanding feature of farm finance in India and other countries in this part of the world. To what extent specialisation has been carried in the west since World War II can be gauged from the example of the U.S.A. The whole country is divided into 12 districts, each possessing 4 separate institutions, (i) a Federal Farm Mortgage Corporation, (ii) a Production Credit Corporation, (iii) a Federal Intermediate Credit Bank, and (iv) a Bank for Co-operatives. Above them all,

co-ordinating and supervising their operations in accordance with a Federal Plan is the Farm Credit Administration. Besides, there are other Federal agencies like the Commodity Credit Corporation, the Farmers' Home Administration, the Rural Electrification Administration, the Farm Loan Division of the Federal Housing Board, and the Federal Mortgage Insurance System. In so far as State aid to private agriculture is concerned, the U.S. system is perhaps the best "all-rounder" in the world.

One distinguishing feature of the Indian system is its highly decentralised character. Financial aid to farmers and agencies financing them is a function of the States of the Union. The U.S.A., Canada and Australia pursue policies intermediate between heavy centralisation and decentralisation. But in India we do not possess any all-India agency which has direct contact with the peasantry.

One thing which should not be, although often is, forgotten is that although the major part of State aid has continued to be given by government departments direct to farmers, the institutional approach was not altogether absent from State activities in the inter-war period. This approach had mainly taken the form of fostering co-operative credit agencies. The Travancore Credit Bank, set up in 1938, is the only instance so far as we know of a specialised, non-co-operative government institution for long-term agricultural financing in India.

Let us now analyse the actual assistance rendered. We shall not, however, discuss the rural loans given to refugees from Pakistan here. These would be examined

in the chapter on rehabilitation financing. Our conclusions and remarks in this chapter will not cover this part of aid to private agriculture.

B. Central Expenditure under G.M.F. Campaign

The main principle followed is to allocate funds to the State Administrations for final disbursement, and not to private individuals, companies and societies direct. This, the Government of India holds, is a sound policy "not only because agriculture is a State subject, but also because the State Governments are better judges of the needs of a private party within their jurisdiction than the Central Government."³ Under this Campaign financial assistance to the States by the Union Government takes the shape of loans and grants which were given for some years to the Part A States only. The scheme now extends to the Part B, C, and D States as well. The following table will provide the necessary information on loans and grants sanctioned by the Government of India for the States from 1943 onwards :

| (Rs. in crores) | | | |
|-----------------|----------|-------------------|---|
| Yr. | Loan | Grant | |
| 1943-47 | .. 6'53 | 8'68 | } |
| 47-48 | .. 0'93 | 1'46 | |
| 48-49 | .. 2'32 | 5'53 | |
| 49-50 | .. 3'73 | 6'09 | |
| 50-51 | .. 11'44 | 0'88 | |
| (Upto 31.1.51) | | | |
| 51-52 | .. 10'55 | 7'45 ⁴ | } |
| 52-53 | .. 17'62 | 6'35 | |
| 53-54 | .. 29'00 | 5'00 ⁵ | |

[Source : "Towards Self-Sufficiency", p. 46].

(Part A & B States only).⁵

³ "Towards Self-Sufficiency" (1951), p. 43.

⁴ The Statesman (Cal.), July 4, 1952.

⁵ P. C. Jain, "Problems in Indian Economics" (1953 ed.).

⁶ Reserve Bank of India, Report on Currency and Finance for 1953-54.

The State Governments themselves incur expenditures on G.M.F. schemes out of their own resources apart from the funds provided by the Central Government on approved schemes. The State Governments grant taccavi loans also out of Central funds for G.M.F. purposes under the Acts of 1883 and 1884. G.M.F. funds are spent also under certain other Acts, e.g., "the East Punjab Tractor Cultivation (Recovery of Charges) Act, 1949," which, however, vary from State to State.*

C. Aid to Co-operative Credit†

The total amount of loans held by the primary agricultural credit societies from the Government stood at Rs. 0·48 crore at the end of the year 1951-52. For the same year Government loans to all the State Co-operative Banks represented 4·9% of the total working capital of Rs. 36·72 crores.⁷ So far as central banks and banking unions were concerned, Government loans stood at 0·29 crore, representing 5% of the total working capital.

The Governments of Madras, Bombay, Bihar, Madhya Bharat, U.P., Orissa and the Punjab have spent large sums as subsidies and grants-in-aid to the co-operative movement. The most important way in which the Government has sought to extend financial backing

* Directorate of Economics and Statistics, Govt. of India, Memo. No. 1990/51—FP. ES.

† This section should be read along with the chapter on Reserve Bank financing of private enterprise.

⁷ The All India Rural Credit Survey, Vol. II, 1954, chs. 18-19.

to co-operative land mortgage banking has consisted in giving guarantees of principal and/or interest of debentures issued by the apex land mortgage institutions in the States where they exist. This system of guaranteeing land bank debentures is in extensive use in countries like Germany, Norway, Sweden, and Denmark. To-day central land mortgage banks are functioning in Bombay, Madras, Mysore, Orissa, Travancore-Cochin, Saurashtra and Hyderabad. The maximum guarantee limit is Rs. 700 lacs for the Central Land Mortgage Bank in Madras where land mortgage banking can be said to have been a moderate success. The maximum guarantee limit is Rs. 50 lacs for the M.P. State Co-operative Bank which acts as a central land bank in relation to the State's primary land banks.*

In so far as the share participation method of aid is concerned, available information follows below⁸ :—

(Rs. in lacs)

| New State Co-op. Banks | Yr. of Incorporation | Total share capital | | Contribution made or proposed to be made by State Govt. |
|------------------------|----------------------|---------------------|-------------------------|---|
| | | Authorised | Paid-up as on 31-3-1954 | |
| Saurashtra .. | 1951 | 20'00 | 6'86 | 5'00 |
| PEPSU .. | 1953 | 15'00 | 3'97 | 3'00 |
| Rajasthan | 1953 | 20'00 | 5'39 | 5'00 |
| Himachal Pradesh | 1953 | 50'00 | not available | 5'00 |
| Madhya Bharat .. | 1953 | 25'00 | 1'07 | 5'00 |
| Travancore-Cochin | 1954 | 20'00 | 6'80 | 5'00 |

* Reserve Bank of India, "Land Mortgage Banks" (1951).

⁸ Source : All India Rural Credit Survey, Vol. II (1954).

| Existing State Co-op. Banks | Yr. of reorganisation | | Paid-up as on 30-6-1953 | |
|-----------------------------|-----------------------|--------------------|-------------------------|-------|
| Assam .. | 1953 | 350'00 | 2'21 ¹ | 10'00 |
| Hyderabad .. | 1952 | 25'00 ² | 9'89 | 4'29 |
| Mysore .. | 1952 | 10'00 | 9'29 | 5'00 |
| Punjab .. | 1953 | 50'00 | 11'44 ³ | 10'00 |
| Vindhya Pradesh .. | 1952 | 10'00 | 0'21 ⁴ | 1'00 |
| West Bengal .. | 1952 | 100'00 | 28'15 | 15'00 |

(Rs. in laks)

| Name of Central Land Mortgage Bank | Year of starting | Total share capital as on 30-9-1953 | State Govt. contribution to share capital |
|------------------------------------|------------------|-------------------------------------|---|
| Saurashtra .. | 1951 | 7'69 | 5'00 |
| Hyderabad .. | 1953 | 1'27 | 1'00 |

Government contributions to the share capital of the Bombay State Co-operative Bank and the central banks as on June 30, 1953, amounted to Rs. 26 laks and Rs. 6'75 laks respectively. As mentioned earlier, the State Bank of India is also going to support co-operative credit institutions.

¹ As on 31-12-1952 ; excludes Rs. 0'09 laks in share suspense account.

² Osmania Currency.

³ Excludes Rs. 0'92 lak in share suspense account.

⁴ As on 30-6-1952.

D. Taccavi Loans

The following statistics will provide an idea of the taccavi financing done by the different State Governments in post-war years* :—

West Bengal

| | | | | | |
|---|---|---------|----|-----|-------------|
| Source : Relief and Rehabilitation Branch, | } | 1945-46 | .. | Rs. | 48,24,169. |
| Co-operation, Credit, Relief & Rehabilitation Dept., W. Bengal, | | 1946-47 | .. | .. | 1,11,60,788 |
| Letter No. 2692-F.R./SP-31/52 | | 1947-48 | .. | .. | 17,49,909 |
| of 9-6-1952. | | 1948-49 | .. | .. | 20,00,000 |
| | | 1949-50 | .. | .. | 23,41,000 |
| | | 1950-51 | .. | .. | 46,89,000. |

[In the 1955-56 Budget, provision has been made for 95 lacs under advances to cultivators, 10 lacs as loans to owners of beel and tank fisheries and to growers of agricultural produce and 29 lacs as cattle purchase loan.—*Statesman*, Feb. 16, 1955.]

Usual interest rate=6¼% per annum. Separate figures of long and short-term loans not available.

Bihar

(in Rs.)

| Year | | L.I.L. Act Loans | A.L. Act Loans |
|---------|----|---------------------|-------------------|
| 1945-46 | .. | 43,906 | 1,46,173 |
| 1946-47 | .. | 1,64,918 | 7,42,009 |
| 1947-48 | .. | 13,79,476 | 4,35,852 |
| 1948-49 | .. | 9,45,499 | 23,87,235 |
| 1949-50 | .. | 28,09,232 | 20,98,933 |
| 1950-51 | .. | 32,79,720 | 86,85,632 |

Usual Interest Rate = 6¼% p.a.

[Source : Revenue Dept., Bihar, Memo. dated 21.12.1951.]

* A not very inconsiderable part of these loans is financed out of centrally-given G.M.F. funds. This fact should be borne in mind while making any estimate of the total volume of aid given by all the Governments concerned, otherwise duplication would be involved.

Madras

| | | Loans for Buying Seeds & Manure Rs. | Loans for Buying Tools Rs. |
|---------|-------|---|-------------------------------------|
| 1945-46 | .. .. | 65,79,118 | 25,911 |
| 1946-47 | .. .. | 50,20,360 | 10,365 |
| 1947-48 | .. .. | 1,67,193 | 3,179 |
| 1948-49 | .. .. | 7,69,105 | 30,792 |
| 1949-50 | .. .. | 28,41,892 | 28,512 |
| 1950-51 | .. .. | 21,97,164 | 29,310 |

[Source : Director of Agriculture, Madras, Letter No. L. Dis. B. 2.805/51, dated 18.10.51]

Usual Interest Rate = $5\frac{1}{2}\%$ *.

Assam

(in Rs.)

| | | A.L. Act Loans | L.I.L. Act Loans |
|---------|-------|-------------------|---------------------|
| 1947-48 | .. .. | 3,52,713 | 25,000 |
| 1948-49 | .. .. | 9,42,581 | — |
| 1949-50 | .. .. | 2,20,874 | 9,500 |
| 1950-51 | .. .. | 4,58,764 | 14,600 |
| 1951-52 | .. .. | 17,72,182 | 63,500 |

Interest Rate = $6\frac{1}{4}\%$

[Source : Addl. Director of Agriculture, Assam, Letter No. GMF. 393(1)/52/10341, dated 24.7.1952.]

Uttar Pradesh

| | | Interest-free Rs. | Interest-bearing. Rs. |
|---------|-------|----------------------|--------------------------|
| 1946-47 | .. .. | 1,73,239 | 5,21,733 |
| 1947-48 | .. .. | 1,08,017 | 4,04,026 |
| 1948-49 | .. .. | 1,88,457 | 12,18,460 |
| 1949-50 | .. .. | 9,11,275 | 20,38,657 |

[Source : Director of Agriculture, U.P., Letter No. 6224/DF—IV—1, of 9.3.1951.]

* Source : "State Aid to Agriculturists in India", an undated Reserve Bank publication.

Madhya Pradesh

(in Rs.)

| Year | Ordinary Taccavi | | G.M.F. Taccavi | |
|------------|------------------|------------|----------------|--------------|
| | Agri. Loans | L.I. Loans | Agri. Loans | L.I. Loans |
| 1944-45 .. | 15,36,251 | 1,80,223 | 14,51,791 | 15,90,185 |
| 1945-46 .. | 5,37,000 | 86,330 | 24,86,969 | 13,73,676 |
| 1946-47 .. | 4,75,023 | — | 28,09,550 | 16,84,615 |
| 1947-48 .. | 53,93,739 | 1,57,489 | 19,31,556 | 44,56,840 |
| 1948-49 .. | 65,19,190 | 5,49,625 | 35,35,352 | 88,51,944 |
| 1949-50 .. | 79,06,098 | 16,01,830 | 80,59,146 | 80,92,514 |
| 1950-51 .. | 52,53,125 | 9,58,500 | 1,03,51,190† | 1,37,84,152† |

[Source : Agriculture (G.M.F.) Dept., M.P., Letter dated 26.10.51.]

The Punjab (I)

Loans granted to ryots under the Scheme for the Sinking of Surface Percolation Wells since 1947-48 (i.e. after August 15, 1947) :—

Rs. 8,35,500 in 1947-48, Rs. 14,84,437 in 1948-49, Rs. 25,93,567 in 1949-50, Rs. 23,99,094 in 1950-51 and Rs. 13,04,260 (revised estimate) in 1951-52, repayable in 15 equal instalments of principal with interest at 3¾% p.a.

In addition, Rs. 10 lacs were sanctioned during 1951-52 for advances to cultivators in kind (in the form of pumping sets), the interest charge being Rs. 4¾% p.a.

[Source : Director of Agriculture, Punjab, Letter No. 12949/F, dated 6.5.1952.]

† Figures indicate allotments sanctioned, not actual disbursements.

Interest Rates = Rs. 7/13/- p.c. for ordinary taccavi and 3¼% and Rs. 4/13/- p.c. for G.M.F. taccavi. In some cases loans are interest-free in the first year. L.I. Loans are repayable in 5 years.

Bombay

| Year | | (Rs. in laks) | |
|---------|----|---------------|---|
| 1944-45 | .. | 25 | } [Source: Hyderabad Govt. Bull. on Econ. Affairs, March 1949, p. 289.] |
| 1945-46 | .. | 49 | |
| 1946-47 | .. | 90 | |
| 1947-48 | .. | over 100 | |

Figures of subsequent years not available according to the Bombay Government. Interest rates=1½%, 3%, 3¼%, 4% and 5½% for loans for various purposes under the G. M. F. drive. Special 1% rate for loans to farming co-operatives.⁹

Himachal Pradesh

Rs. 46,980 as agricultural loans at 4% p.a. and Rs. 5,000 as land improvement loans at 4% p.a. given to cultivators up to December, 1951.

[Source : Letter from Assistant Secretary, Home & Revenue, Himachal Pradesh, No. R. 87-4/48. II, dated 6.8.1952.]

PEPSU

Loans given upto Sept., 1951 :—Rs. 8,40,879/6/3 for purchase of tractors and implements, recoverable in 15 equated six-monthly instalments of principal and interest starting after one year, at 4%, and Rs. 93,500/11/6 for sinking tube-wells recoverable in 15 years at 4%.

[Source : Dept. of Agriculture & Forest—Food Production Section—PEPSU, Letter No. FP/30/5280, dated 14.9.1951.]

Ajmere

Taccavi loans advanced under the Well Sinking Scheme :

⁹ "Helping You Grow More Food" (1951), supplied by the Bombay Govt.

| | | | Rs. |
|---------|----|----|----------|
| 1945-46 | .. | .. | 20,150 |
| 1946-47 | .. | .. | 3,71,900 |
| 1948-49 | .. | .. | 88,700 |
| 1949-50 | .. | .. | — |
| 1951-52 | .. | .. | 2,42,025 |

Data of 1947-48 and 1950-51 not supplied.

[Source : Agricultural Officer, Ajmere, Letter No. 1945/W—47, dated 10.3.1952.] °

Coorg

| | | | L.I. Loans Rs. | Agri. Loans Rs. |
|------|----|----|-------------------|--------------------|
| 1945 | .. | .. | 18,150 | 38,440 |
| 1946 | .. | .. | 18,830 | 33,630 |
| 1947 | .. | .. | 12,250 | 32,370 |
| 1948 | .. | .. | 39,760 | 43,090 |
| 1949 | .. | .. | 49,175 | 48,740 |
| 1950 | .. | .. | 24,180 | 49,930 |
| 1951 | .. | .. | 21,970 | 78,200 |

[Source : Treasury Officer, Coorg, Letter Dis. No. 797, dated 15.3.1952.]

Rajasthan

In the financial year 1950-51, Rs. 7 lacs were advanced as loans for the purchase of agricultural machinery, Rs. 3 lacs for pumping sets, and Rs. 3 lacs for purchasing bullocks at 3 1/8% per year. Rs. 10 lacs were disbursed during 1951-52. The budget provision for 1952-53 was Rs. 36 lacs.

[Source : *Statesman*, Sept. 17, 1951 and April 9, 1952.]

Madhya Bharat

Loans sanctioned under various Food Production Drive Schemes :

(in Rs.)

| Name of Schemes | 1949-50 | 1950-51 |
|--------------------------|----------|-----------|
| Well Sinking & Repair .. | 7,08,035 | 15,48,800 |
| Bullocks & Seed, etc. .. | 6,17,368 | 3,36,283 |
| Pump Installation .. | 4,17,217 | 8,32,850 |
| Field Embankments .. | 15,975 | 1,23,800 |
| Manures .. | 4,000 | 8,000 |
| Tractor Purchase .. | 2,00,000 | 3,00,280 |
| Persian Wheels .. | — | 6,200 |
| Re-settlement .. | — | 56,584 |

The Government earmarked Rs. 1 crore for loans during 1951-52. Interest rate for all loans is 4%, except for those in connection with pump installation which are interest-free.

[Source : Development and Labour Depts., M.B., Letter No. 157/XAP of 1952, dated 8.5.1952.]

Bhopal

| 1949 | 1950-51 | 1951-52 |
|--------------|--------------|--------------|
| Rs. 1,00,500 | Rs. 9,01,627 | Rs. 6,64,390 |

[Source : Bhopal, Revenue Dept., Memo. No. 5845/1—1—M/52, dated 23.7.1952 and Memo. No. 2635/1—1—M/52, dated 16.4.1952.]

Hyderabad (Deccan)

(in Rs.)

| Year | Agri. Loans | Year | L.I. Loans |
|------------|----------------|------------|----------------|
| 1945-46 .. | 43,87,079/6 | 1945 .. | 1,60,000 |
| 1946-47 .. | 73,04,140/14 | 1946 .. | 1,60,000 |
| 1947-48 .. | 78,98,701/3 | 1947 .. | 1,60,000 |
| 1948-49 .. | 70,86,686/5 | 1948 .. | 1,50,000 |
| 1949-50 .. | 31,20,668 o.s. | 1949 .. | 1,50,000 |
| 1950-51 .. | 67,75,891 o.s. | 1950-51 .. | 44,88,647 o.s. |

Agri. loans are interest-free, whilst L.I. loans carry 6¼% per annum.

[Source : Director of Agriculture, Hyderabad, Letter No. 90/50/GMF/Mis/3506, dated 1.7.1952, and Secretary, Revenue Dept., Hyd., Letter No. 5081/B3/38/52, dated 8.11.1952.]

Travancore-Cochin

Taccavi loans are issued, not by the Government, but by the Travancore Credit Bank, a Government agency. At the end of 1948-49, long-term loans stood at Rs. 47.22 lacs and short-term loans at Rs. 0.22 lak*. A large portion of these loans has financed agriculture the rest having fallen to the share of industry.

Saurashtra

Loans given in some important districts :

Halar Collectorate

(in Rs.)

| Year | | L.I. Loans | Agri. Loans |
|---------|----|-------------|-------------|
| 1948-49 | .. | .. 3,14,904 | 2,20,084 |
| 1949-50 | .. | .. 4,39,132 | 2,55,476 |
| 1950-51 | .. | .. 2,53,726 | 1,99,099 |

(Halar Collectorate, Memo. No. CH/Rev./790, of 6.5.1952.)

Zalawad

| | Rs. | | Rs. |
|---------|----------------|---------|--------------|
| 1948-49 | .. 22,72,094.5 | 1950-51 | .. 6,13,491 |
| 1949-50 | .. 28,86,703 | 1951-52 | .. 20,55,871 |

(Zalawad Collectorate, Memo. No. TAG/1420, of 14.6.1952).

Sorath District

| | L.I. Loans | Agri. Loans (in Rs.) | G.M.F., Cotton & Jute Campaign Loans |
|---------|--------------|-------------------------|---|
| 1949-50 | 3,02,902 | .. 1,26,846 | .. 2,31,392 |
| 1950-51 | 71,867/10 | .. 7,79,608 | .. 35,43,066 |
| 1951-52 | 11,85,930/12 | .. 2,04,880 | .. 19,80,700 |

(Collectorate, Junagad, No. TAG/811, dated 24.5.1952.)

Interest rate=5½% for long-term and 2½% for short-term loans.

In the Saurashtra Budget for 1952-53, Rs. 60 lacs were provided as loans.¹⁰

* Reserve Bank of India, "Land Mortgage Banks" (1951).

¹⁰ *The Statesman* (Cal.), March 21, 1952, p. 3.

Orissa

Long and short-term taccavi loans (in Rs.)

| Name of scheme | 1945-46 | 1946-47 | 1947-48 | 1948-49 | 1949-50 | 1950-51 |
|--------------------------------------|-----------|----------|-----------|-----------|----------|-------------|
| 1. Fallow land reclamation .. | 10,05,450 | 9,95,719 | 2,40,000 | 4,64,275 | — | — |
| 2. Improvement of cultivated land .. | — | — | 10,00,000 | 10,00,000 | — | — |
| 3. Pucca wells .. | 1,99,900 | 1,00,000 | 2,66,000 | 3,21,440 | Scheme | Transferred |
| 4. New tanks .. | 5,07,200 | 1,00,000 | 3,43,992 | 2,63,000 | " | " |
| 5. Old tanks .. | 2,08,000 | 1,96,200 | — | 4,34,475 | — | — |
| 6. Ploughs and bullocks .. | 3,18,270 | 3,60,000 | 5,00,000 | 6,88,205 | — | — |
| 7. Agri. tools .. | — | — | — | — | nil | nil |
| 8. Seeds .. | 8,82,186 | 5,91,893 | 3,06,096 | 2,35,415 | 2,65,606 | 1,56,650 |
| 9. Minor irrigation projects .. | — | — | — | 71,595 | — | — |

Interest rate:—Scheme 8 is interest-free. Loans for other schemes are interest-free for a part of their duration, and thereafter bear $3\frac{1}{4}\%$ p.a.
 (Source: Director of Agriculture and Food Production, Orissa, Letter No. 2747/F.P. 2M-9D-52.)

Mysore

| | L. I. Loans Rs. | A. Loans Rs. | (Sanctioned) |
|------------------------|------------------------------|-----------------|--------------|
| 1945-46 | 1,26,401 | 2,14,203 | |
| 1948-49 | 2,36,415 | 8,60,625 | |
| | 5,000 as Fruit Culture Loans | | |
| | Rs. | Rs. | |
| 1949-50 } 1950-51 } | 2,55,395 | 4,50,751 | |

From Nov. 1945 upto 1949-50, taccavi loans were advanced at a reduced rate of 2% and a penal rate of 4%.

[Source : Mysore Information Bulletin, May-June 1947, Sept.-Oct. 1950, Oct.-Nov. 1951, April 1948, and March 1950.]

E. An Appraisal

The record of governmental assistance may be considered from two important standpoints which are : the volume of assistance rendered, and the interest-cost of that assistance.

Volume

Our study reveals a rising trend of State aid. The co-operative movement has been receiving increasing financial support from the State in recent years. But this support has not been adequate. Co-operatives still raise the bulk of their resources from non-government sources under heavy odds. The guarantee system has not worked with success. For instance, in Mysore the Central Co-operative Land Mortgage Bank has failed to sell its State-guaranteed debentures to the desired extent. The guarantee system yields good results in rich countries like the U.S.A. In poor countries with inadequate total investible savings and under-developed finance markets, it is not likely to prove a great success.

It would be certainly misleading to suggest that the poor results of co-operative credit so far are entirely due to the poor financial support given by the State. But I think that there were no good reasons as to why deviations could not have been made from the traditional methods of aid. For instance, where a co-operative was functioning successfully, consideration could have been given to the possibility of extending to depositors some sort of deposit guarantee.

The outlay on the G. M. F. Campaign does likewise reveal a rising trend since 1943. But it has not yielded the expected results.* And the inadequacy of aid given to ryots is one of the causes.

Debt relief legislation and anti-money-lending legislation in the different States were aimed at a partial solution of the rural credit problem. But the result of these two sets of legislative measures has been a tightening of credit in general.

Taccavi financing requires a separate examination because it is not only an integral part of the G. M. F. drive, but is much older than the latter and has been done by the State as a normal activity outside the pale of the Campaign. Increasing provisions are being made for taccavi loans to farmers in the different State budgets. The amount of taccavi loans sanctioned in the whole of India in 1949-50 was about Rs. 15 crores as against Rs. 1 crore in 1938-39.† But according to the All India Rural Credit Survey (Vol. II, published in

* The recent abolition of food control cannot be wholly attributed to this Campaign.

† Source : The First Five Year Plan.

1954), the all-India average for borrowings of cultivators from Government as a percentage of their total borrowings is only 3.3 p.c. The total annual borrowings of cultivators from all sources may be put for the whole of India at Rs. 750 crores at the current level of production.* Loans for old debt redemption, for which long-term aid is very often required by the Indian peasant, are excluded from the purview of taccavi legislation in many States under rules framed by them. Naturally, the village mahajan is still an evil necessity. In cases where the village money-lender has failed to function as a large-scale supplier of finance, government loans have failed to fill the resulting gap. In a country like India where the agricultural economy requires a thorough reorganisation and transformation, long-term development loans will naturally occupy a very important place in any scheme of financial assistance. But from the data available to us and given in the preceding pages it emerges that in most of the important States of India, the major portion of total loans sanctioned has been short-term loans and not long-term land improvement loans.¹¹ The smallness of individual loans can be gauged from the following data. In one State the rule is that the maximum short-run loan in any individual case should not exceed Rs. 25. The average loan for livestock purchase has been calculated as Rs. 117 in Orissa, Rs. 149 in West Bengal, Rs. 211

† All India Rural Credit Survey (Vol. II, p. 156).

¹¹ But according to the All India Rural Credit Survey, "In relation to the total finance from Government, long-term loans (including . . . medium-term loans) from the State are by far the most important." (Vol. II, p. 201).

in Hyderabad and Rs. 240 in Rajasthan. The actual loan granted has not exceeded 50% of the requirement indicated.

Interest Cost

It is not so easy to determine the optimum structure of farm interest rates in a country like India where a basic scarcity of loanable funds has been in existence for a long time. Taking for the time being $6\frac{1}{4}\%$ as the most desirable rate for farm loans under ruling conditions, as suggested by the Gadgil Committee in 1945, it appears that the interest price is fairly high for that part of government aid which is channelled through the co-operative sector, while for the other part given directly as taccavi loans, it is, on the whole, near the desirable level. But the latter fact ought not to be over-emphasised. For, in the first place, such loans touch only the fringe of the farmer's financial requirements. Secondly, small cultivators, as a group, secure only about 9.8% of total loans made available by the State.¹² And finally, other costs of securing taccavi loans have in most cases been so high that the benefit of low interest rates has been generally nullified. The ryot has to gratify substantially the subordinate revenue officials and other small intermediate functionaries to obtain the sanction and payment of loans. From the angle of cost, then, taccavi loans somewhat resemble the loans given by the mahajan.

Some Defects of Taccavi Loans

Moreover, the administration of taccavi finance has revealed other defects too wellknown to require any

¹² See the All India Rural Credit Survey, Vol. II, p. 202.

detailed analysis here. They are : lack of elasticity, rigidity in the method of collection, inconvenience of timing, undue delays in the sanction and disposal of loan applications, and inappropriateness of the basis of security demanded (which renders large sections of agriculturists ineligible for loans). These factors, coupled with the characteristic apathy of the farmer to deal with government agencies and officials and his ignorance, have rendered the taccavi system largely infructuous in so far as an appreciable and general fall of credit costs and an adequate credit supply are concerned.

Other Considerations

One very important, though roundabout, effect of public assistance in countries like the U.S.A. and Canada has consisted in the competitive stimulus imparted to private financing activities. In India, the stimulus seems to have worked rather in the opposite direction. For many years the money-lender has been slowly but unmistakably transferring the employment of his capital from agriculture to non-agricultural businesses,* and a gap has been developing in the private financial mechanism.

A serious hindrance to land mortgage credit in India, as in other countries of South and South-East Asia, is the lack of clear and eligible title deeds. Another hindrance is the inability of the farmer to furnish adequate security against which loans, especially long-term loans, are to be advanced. This difficulty can be met to some extent if an alternative safeguard can be provided for in the shape of agricultural insurance.

* *Capital*, October 5, 1950.

Not only there is no arrangement in our country of insurance of mortgages, crops and other assets of the ryot by government agencies, but insurance by private agencies is also a desideratum. Insurance to cover farm risks is a factor making for increased credit-worthiness.

Lack of co-ordination is another defect of State aid. There are instances of far too many departments having been entrusted with the task of providing farm finance directly or indirectly. "Lack of co-ordination occurs not only between one department of Government and another, but between Government on the one side and the co-operative credit agency of the State on the other." In many instances, Government departments have been giving loans for the very purpose for which co-operatives can and do advance loans, at rates lower than those of co-operative agencies. What is needed at this hour is not only well-equipped credit institutions, but institutions integrated thoroughly according to a definite plan so that the wastage of resources can be kept at a minimum.

Expert opinion in India has been broadly in agreement with international opinion in demanding a gradual replacement of departmental financing by institutional financing. The Report (1938) of the League of Nations on Systems of Agricultural Credit and Insurance has expressed that only in exceptional circumstances should Government departments themselves grant credits. The Report (1944) of the Australian Rural Reconstruction Commission has held the practice of direct departmental aid as undesirable. In India, the Royal Commission on

Agriculture, the Indian Central Banking Inquiry Committee and the Gadgil Committee had explicitly preferred credit distribution generally through specially created machinery, except in special conditions. Recently, the Gorwala Committee (*vide* the All India Rural Credit Survey, Vol. II) has recommended that Taccavi should hereafter be restricted to "periods of famine and similar distress". We have complete accord with these views. But, what should be the character or type of the special institutions through which the bulk of State aid is to be distributed ? To accept the co-operative solution despite all its known deficiencies and the difficulties in the way of its successful implementation in India was the vogue of the pre-war era. But by the end of World War II the unrivalled sway of the co-operative school had gone. While the co-operative short-term credit organisation had underwent noticeable, though far from adequate, extensions through opportunities laid bare by the war, co-operative land mortgage banking registered a rate of progress which towards the end of the war gave rise to serious misgivings about the wisdom of relying any further upon the co-operative solution for meeting the unsatisfied and growing demand of agriculture for long-dated capital. It is amid such an atmosphere of doubt and frustration that the Report (1945) of the Agricultural Finance Sub-Committee of the Government of India's Policy Committee on Agriculture, better known as the Gadgil Committee, opened the agricultural finance corporation vs. co-operation debate in right earnest. The Committee recommended the creation of regional agricultural finance corporations. But alternative proposals for the creation of an All India

A. F. C. also came from several quarters. The points raised, killed and resuscitated in course of this famous controversy make an interesting reading.* But it would not be possible for us to reproduce the controversy here. We shall be content to conclude this chapter with a brief reference to the latest position in respect of the controversy. Government policy, as chalked out in the First Five Year Plan, has been to stress the reconstruction and development of co-operative agencies. Although the record of co-operative credit in the last 50 years is one of 'failure', the Report of the Committee of Direction of the All India Rural Credit Survey† has recommended co-operation as the best form institutional credit can take under Indian conditions.¹³ According to the Committee, "the problem is not so much one of re-organisation of co-operative credit as of the creation of new conditions in which it can operate effectively and for the benefit of the weaker," and the necessary forces of transformation can be generated not by co-operation alone but by co-operation in conjunction with the State. The main features of the Committee's 'Integrated Scheme' of rural credit are as follows. The principles of organisation will be : (i) State partnership in co-operative rural credit, (ii) State partnership in a programme for the organisation of processing and marketing on a co-operative basis and

* The interested reader may consult in this connection my article entitled "The Controversy over Agricultural Finance Corporations" (*Indian Journal of Commerce*, June 1953), and the *All India Rural Credit Survey* (Vol. II, ch. 10).

† Vol. II.

¹³ The Madhya Pradesh Taccavi Policy Committee (reporting in 1954) also suggested that co-operatives should ultimately be the proper agency for the distribution of Taccavi loans.

for the development of storage and warehousing, (iii) State partnership in a programme for the co-operative organisation of other economic activities of the villager as are important to him as cultivator, farm labourer or artisan, (iv) integration of, and State's financial participation in, an important sector of commercial banking for helping the growth of rural and co-operative banking, (v) recognition of the importance of training a new type of personnel, (vi) recognition of the need to prevent State participation from degenerating into day-to-day interference and prejudicing the essential character of the institution in question*, and (vii) recognition of the need to mobilize rural savings through rural people's agencies and to utilize these for their benefit. The main lines of reorganisation and development will be : (a) strengthening of co-operative credit institutions at all levels ; (b) organisation of co-operative marketing and processing, and the development of storage and warehousing with State help ; (c) establishment of a State Bank of India through the amalgamation of the Imperial Bank and certain State-associated banks ; major State participation in the new institution ; the expansion of the State Bank and the conversion, through this programme, of a large number of non-banking treasuries into banking treasuries ; the effecting thereby of an increase of facilities for remittance of money ; and support by this Bank to the co-operative structure. Besides the State Governments and the Planning Commission, the main instruments of this programme will be : the Reserve Bank of India, the

* The practicability of this principle is doubtful.

Central Ministry of Food and Agriculture, the proposed National Co-operative Development and Warehousing Board, the proposed All India Warehousing Corporation and the State Warehousing Companies, the proposed State Bank of India, the proposed Central Committee for Co-operative Training, and the Co-operative Movement itself. Finance would come from the following sources:

- (i) Under the Reserve Bank
 - (a) The proposed National Agricultural Credit (Long-term Operations) Fund.
 - (b) The proposed National Agricultural Credit (Stabilisation) Fund.
- (ii) Under the Food and Agriculture Ministry
 - The proposed National Agricultural Credit (Relief and Guarantee) Fund.
- (iii) Under the proposed National Co-operative Development and Warehousing Board
 - (a) The proposed National Co-operative Development Fund.
 - (b) The proposed National Warehousing Development Fund.
- (iv) Under the proposed State Bank of India : The Integration and Development Fund.
- (v) Under each State Government
 - (a) The proposed State Agricultural Credit (Relief and Guarantee) Fund.
 - (b) The proposed State Co-operative Development Fund.

- (vi) Under each State Co-operative Bank, central co-operative bank, etc.

The proposed Agricultural Credit Stabilisation Fund.

The Government of India has accepted the proposal for the creation of a State Bank of India on the lines suggested. The State Bank of India and the two Funds under the Reserve Bank have already been set up. Other recommendations are under its consideration. The controversy over non-co-operative credit agencies can be said to have been laid at rest for the present. But whether co-operation will be a successful solution of the farm credit problem under condition of small peasant proprietorship as envisaged in the First Five Year Plan is yet to be seen. Exactly what part the State Bank will play in agricultural credit is not yet quite clear. Nevertheless, it must be admitted that the State efforts of the last ten years have considerably extended the facilities of farm credit in our country.

CHAPTER XI

FINANCING REFUGEE REHABILITATION

[Refugee rehabilitation is a two-fold operation, beginning with relief and ending with rehabilitation on a permanent basis. In this chapter an attempt has been made to study refugee financing in India from a particular standpoint, namely, that of government financing of private enterprise. This has necessarily involved the exclusion of the entire relief aspect from our survey. For the same reason, again, no detailed reference has been made to some government activities which directly aim more at giving some collective benefits than at promoting the private effort of individual refugees. It was not possible to do the subject more justice in course of a single chapter of a book like this.]

Communal-cum-political disturbances before and after the partition of India on August 15, 1947, resulted in gigantic mass migrations of non-Muslim people from Pakistan into India (divided), a problem unprecedented in size and nature in Indian economic history. The finances of the country were taxed to the utmost, the economic life of the land, especially in the two border States of West Bengal and the Punjab(I), was strained almost to the breaking point under the impact of this titanic problem. The exodus, involving millions from both wings of Pakistan, was continuous and sweeping in character, and turned, after the lapse of some time, into a near-permanent transplantation of people. The Government had to find the ways and means of these evacuees' smooth and permanent absorption into the

existing economic framework with the minimum possible repercussions upon the latter. The job was to be done speedily at the same time. It was an extremely difficult and almost puzzling job, for it had to be accomplished with the limited funds at the Government's disposal coming out of the low national income of the rest of the population. But the Government did face the task with courage and determination. And although the influx has not ceased even unto this day, a substantial part of the job (particularly that relating to the West Pakistan refugees) has by now been done not entirely without success.

General Features

The work of integrating displaced persons into the existing economic system has been carried out in two stages: interim relief in the first instance involving arrangements for these persons' food, shelter and clothing as soon as they have arrived, and next, permanent rehabilitation to end the necessity of continued relief by means of various opportunities of useful employment and financing, in the necessary cases, this transition from dependence upon public charity to self-help and self-reliance. The whole programme of refugee resettlement is administered by the various State Governments and Government-of-India-sponsored organisations like the Rehabilitation Finance Administration, the Faridabad Development Board, the Rajpura Development Board and the Sindhu Resettlement Corporation, under schemes sanctioned by the Union Rehabilitation Ministry. Apart from the insignificant

sums spent by the State Governments from their own revenues, all the funds come from the Union Government.

During 1947-52 (i.e. up to March 31, 1952) rehabilitation absorbed more than half of the total refugee expenditures which amounted to Rs. 146.30 crores. The trend is to spend increasingly larger sums on rehabilitation, and rightly so. Relief cannot yield the maximum result unless it is followed by large-scale rehabilitation on a stable and permanent basis.

The unique and emergency character of the problem required its solution upon a special basis. Naturally, from the very outset the Government kept the subject on a separate footing from that of financing private enterprise in general and devised special measures of financial aid to refugee enterprise in agriculture, industry, house-building, etc. The wisdom of this policy lay in that it considerably reduced the severe strain which might otherwise have fallen upon the normal-time machinery of private business financing, had the latter been called upon to accomplish a task which was full of grave and incalculable risks. The over-all pattern of financing refugee enterprise has not, however, departed very much from that of financing normal-time private effort. As in the case of the latter, it is an inter-mixture of direct departmental financing and assistance by specialist agencies. Nor are the financing techniques fundamentally different in the two cases. The distinction rests chiefly in the terms and conditions of aid and in the economic status of the aided enterprises.

Because of the varying needs of rural and urban folk, refugee rehabilitation has been divided into two

parts, namely, rural rehabilitation and urban rehabilitation. Rural rehabilitation needed the provision of houses and suitable land-units to displaced cultivators and landowners from Pakistan and financing their purchase of other factors of farm production. It further involved facilitating the resettlement of landless rural labourers and artisans and petty rural traders in a new rural order. The problem of urban resettlement has been "one of great complexity". The displaced urban population included traders and shopkeepers, small artisans, big industrialists and businessmen, doctors, lawyers and teachers, men of the service class, town workers, unattached women and children, and several other special groups. The problem of rehabilitating these diverse groups naturally needed a many-sided attack. The complexity of the problem was further enhanced by the fact that the urban economy of India, during the war and post-war years, had been stretched to capacity, and any further economic assimilation offered no ready solution. The specific character of the housing problem, particularly serious in the case of urban settlers, compelled the adoption of specific measures within the framework of refugee rehabilitation.

Rural Rehabilitation

Financing rural resettlement has generally been done by allotments of land to displaced agriculturists, accompanied by loans for such purposes as their feeding for a period of 6 to 9 months until their first crops are ready, the purchase of food, seeds, bullocks and implements, and the construction of houses and wells. Loans

are also granted to rural artisans. Interest-rates on these loans are much lower than those on loans made to the normal residents of India under the Agriculturists Loans Act and the Land Improvement Loans Act. The total amount of loans advanced to rural settlers from West Pakistan till the end of 1953-54 "is expected to amount to Rs. 9.10 crores" according to the Rehabilitation Ministry's Report for 1953-54. Provision for 1954-55 is Rs. 20 lacs. The average amount of loan is Rs. 1,150 per family.¹ The total amount of loans advanced to the various State Governments for grant of rural loans to settlers from East Pakistan upto the end of March, 1953, is Rs. 7.75 crores.²

Urban Rehabilitation

The programme has been mainly a 4-point one, covering assistance through loans, finding gainful employment with the aid of the employment exchanges, provision of business premises, and vocational and technical training. So far as we are concerned, the chief item of interest is, of course, the arrangement for cheap loans. Loans for urban settlers are issued from two levels according to their size. There is the Rehabilitation Finance Administration, an All India Govt. institution, catering to the needs of the comparatively bigger type of businessmen and industrialists whose demand exceeds Rs. 5,000 ; those whose needs run up to Rs. 5,000 are helped under the Small Loans Scheme, administered by the State Governments. The R. F. A. will be discussed in details subse-

¹ Source : Summary of the Report (1953-54) of the Union Ministry of Rehabilitation.

² *Ibid.*

quently. What follows immediately is an analysis of the experience of other urban loans.

The Small Loans Scheme for the benefit of refugees intending to settle in urban regions came into operation in 1948. The maximum loan payable to a single party is Rs. 5,000.* Loans are usually encouraged to groups and co-operatives so that the benefits might reach larger circles of people. These are granted for medium-to-long-term purposes, and are usually interest-free in the first year. The rate of interest was 3% till the end of 1950. At present it is $3\frac{1}{8}\%$.³ The purposes to be served cover housing and water supply, besides settling in business and professions. The figures of Small Loans are: Loans upto 1952-53=Rs. 11.34 crores, allotment for 1953-54 = Rs. 1.50 crores ; provision for 1954-55 = Rs. 1.40 crores in so far as refugees from W. Pakistan are concerned ; for E. Pakistan refugees, loans upto 1952-53 = Rs. 6.15 crores ; allotment for 1953-54 = Rs. 1.30 crores, and provision for 1954-55 = Rs. 2.31 crores.⁴ Until recently, urban loans were confined to residents of new townships or passed out trainees (under the schemes of the Union Government) intending to set up their own business. "It has, however, been decided to integrate the grant of these loans with the compensation scheme and to advance a larger proportion of such loans to displaced persons having verified claims."

Educational loans are a special category of urban loans. Upto March 31, 1952, Rs. 49 lacs had been

* No such restriction in the case of groups and co-operative societies.

³ Report (1952-53) of the Union Rehabilitation Ministry.

⁴ Report (1953-54).

advanced to displaced students from W. Pakistan for prosecuting their studies in India. Besides, over Rs. 7 lacs were given to 99 students overseas, who were stranded in the wake of the Partition in the middle of their studies abroad.⁵

In urban rehabilitation the emphasis by the State Governments is upon enabling refugees to set up small and co-operative enterprises requiring a nominal capital. This objective is being served not only by loans under the Small Loans Scheme, and to some extent, by the loan operations of the R. F. A., but also by expenditures on vocational training with a view to imparting the necessary experience of production on commercial lines. Financial aid to trainees takes the form of stipends and scholarships. The passed-out trainees are helped with Small Loans.

The rehabilitation of refugees has been adversely affected by the economic depression with the result that there is a good deal of unemployment, particularly in the new townships. In order to create employment outlets for these people, the Government has recently decided to encourage the establishment of industries in and around government-sponsored colonies as well as in areas having large concentrations of displaced persons. On condition that the industries undertook to recruit from among d.p.'s their entire unskilled labour and as much skilled and semi-skilled labour as practicable, the Govt. would provide them with factory sites either by outright sale on credit at 4% per annum or on rent. In addition, loans upto 50% of the value of the machinery to be installed

⁵ Report (1951-52).

would be given by the Govt. for 7 to 10 years.⁶ A provision of Rs. 75 lacs has been made in 1954-55 in this connection.⁷

Housing

A major part of government expenditure in the sphere of refugee financing is accounted for by housing. By the end of 1953-54, housing outlay had totalled Rs. 65·10 crores.⁸ A substantial part of the outlay is on projects which are really public works in character. The salient features of that part which can be said to have financed refugee housing on private account are house-building loans to co-operatives and individuals and the scheme (not widely adopted) of regional housing finance corporations to draw private capital for the promotion of housing plans of upper and middle-class displaced persons. The housing programme has been virtually confined to the urban areas where the housing difficulty has been most widespread and most serious.

The scheme of housing finance corporations, sponsored by the Government of India and generally favoured by the State Governments, constitutes an interesting example of governmental attempt to extend financial help to private housing through specialised institutions. In pursuance of this plan, the Central Government sanctioned in 1950 the flotation of a Housing Corporation in New Delhi with an authorised capital of Rs. 50 lacs, of which the Government would take up 51 p.c. The Corporation was to construct houses for persons prepared to pay full price. Later on, it was to

⁶ *The Statesman*, January 7, 1955.

⁷ Report (1953-54). ⁸ *Ibid.*

sell houses on hire-purchase terms.⁹ Up to March 31, 1952, the Central Government spent Rs. 0·53 crores on the purchase of shares in these Housing Corporations.¹⁰

Provision for Special Interests

A feature of rehabilitation financing is the special arrangements for certain specially-handicapped classes of refugees. For example, a Displaced Harijan Rehabilitation Board has been set up to look after the interests of Harijan refugees. Its activities comprise the construction of houses, securing land, making loans and finding employment for displaced Harijans. Again, with a view to assisting displaced service and ex-service personnel from Pakistan, a Defence Services' Rehabilitation Organisation has been created by the Central Defence Ministry.

Total Expenditure

According to the Government of India, "up to the end of 1953-54, a sum of Rs. 201·02 crores will have been spent on displaced persons . . . as shown below :—

| | <i>(Rs. in crores)</i> | | Total |
|-----------------------|----------------------------------|----------------------------------|----------------|
| | On d.p.'s from W. Pakistan | On d.p.'s from E. Pakistan | |
| I. Grants | .. 63·48 | 24·80 | 88·28 |
| II. Loans | .. 21·72 | 17·07 | 38·79 |
| III. Housing | .. 51·76 | 13·34 | 65·10 |
| IV. Establishment | .. 1·03 | ·09 | 1·12 |
| V. Miscellaneous | .. ·01 | — | ·01 |
| TOTAL | 138·00 | 55·30 | 193·30 |
| VI. Loans by R. F. A. | .. | .. | 7·72 |
| | | | 201·02* |

⁹ *Capital*, January 4, 1951, p. 16.

¹⁰ *Vide* Report (1951-52) of the Rehabilitation Ministry.

* Report (1953-54).

Total provision for refugees for 1954-55 is Rs. 30'44 crores.¹¹

Foreign Experience in Refugee Financing

During the years immediately following World War II, the problem of immigrants or refugees was faced by Governments in several parts of Asia and Europe. Into Pakistan large numbers of Muslims went from India around the days of the Partition in 1947. Apart from Pakistan and India, another Asiatic country which has been tackling a huge refugee problem is the newly-formed Jewish State of Israel. In Europe, the war created a gigantic refugee problem, the worst and heaviest burden of which fell upon the two halves of Germany. An enquiry into the techniques of rehabilitation financing employed in these countries would be greatly helpful in appraising those used in our own country.

Pakistan—Nearly the same techniques are being used here as in India. The whole business is being done in two stages—temporary relief followed by permanent rehabilitation. Rehabilitation is either urban or rural. So far as private enterprise is concerned, the method of assistance mostly resorted to is the grant of loans, not only by the State Governments but also by a special govt. agency, viz., the Refugees Rehabilitation Finance Corporation. The housing problem has been handled on a specific footing. There is a scheme for organising a Central House Finance Corporation backed by State participation,¹² with functions and powers closely

¹¹ *Ibid.*

¹² *The Statesman* (Cal.), April 21, 1951.

analogous to those of the regional Housing Finance Corporations in India. In all these respects, then, the Pakistan system has much in common with that of India. The programme of financing resettlement is being carried out, not as an appendix to financing private effort in industry or agriculture in general, but as something special and separate, through special refugee rehabilitation departments and institutions financially supported by the State, on an emergency basis. This has involved, as in India, not the extension or liberalisation of the scope of the existing machinery for helping private business, but the evolution of separate, independent policies and plans.

More needs to be said about the Refugees Rehabilitation Finance Corporation. The salient features of this institution are given in the Pakistan Refugees Rehabilitation Finance Corporation Ordinance, 1948, as amended by the Pakistan Refugees Rehabilitation Finance Corporation (Amendment) Act, 1950. The Corporation is a Central agency, having an authorised capital of Rs. 3 crores, supplied by the Central Government. Its functions are : (1) to assist rehabilitation by making loans to refugee shop-keepers, cottage workers, artisans and agriculturists, acting individually or in association with a co-operative society or company formed for resettlement purposes ; (2) to advance loans to Provincial Governments for undertaking co-operative schemes devoted entirely to rehabilitation ; (3) to organise schemes of resettling refugees in cottage industries and to arrange for the manufacture of articles by cottage workers ; and (4) with the Central Government's permission, to take over the operation of existing abandoned

factories or businesses for which allottees capable of running them efficiently cannot be found. The Corporation can charge a maximum 4½%, in cash or in kind, on its loans which cannot exceed Rs. 500 for an individual, Rs. 2,000 for a company or partnership, and Rs. 5,000 for a co-operative society.¹³ Sometime ago its scope was extended to cover house-building.

Israel*—The number of Jewish immigrants during the three and a half years after the birth of Israel rose to 109% of the total Jewish population at the beginning of the period. After being given interim relief for some time, immigrants are resettled either in rural occupations or in urban business and industry. But unlike in India, the major part of the work is done, not by government departments directly, but by institutions—the National Institutions like the Jewish Agency and specialised institutions like the ‘Amidar’.

There is no exact parallel to the National Institutions of Israel in India. The Jewish Agency is the front-ranking among such Institutions. It has accomplished the largest part of relief work for immigrants and taken an important part in facilitating permanent resettlement in agriculture with aid in cash as well as in kind. It has further assisted house-building. Another Central agency promoting direct government action in rural rehabilitation is the ‘Mekoroth’ Company, owned jointly by the Government, the Jewish Agency, and the

¹³ Information supplied by the office of the High Commissioner for India in Pakistan, Karachi, Letter No. D12/51—Genl., dated 9-1-1952.

* Source : Letter from Dr. I. Guelfat, Director of Economic Research, Department Treasury, State of Israel, dated 1-11-1951.

Trade Unions, and responsible for the supply of sufficient water to settlers in all parts of the country on a non-profit basis. New settlers can get land for a lease on a rental basis from the 'Keren Kayemeth', another public company buying land for resettlement purposes. While there are no exact counterparts of such companies in India, in Israel there seems to exist no agency of the type of the Indian Rehabilitation Finance Administration.

As in India, housing has posed a serious problem, and the Government has had to contrive special measures for tackling it successfully. In addition to the work of the Jewish Agency, the Government has constructed houses itself for distribution on a low rental basis among the poorer sections of the new-comers, and helped others in purchasing houses with down-payments, supplemented by loans in necessary cases, redeemable in 5 to 10 years. The task of fulfilling State building plans for immigrants is, however, being gradually transferred to a specialist Central agency, namely the 'Amidar' (the Israel National Housing Corporation for Immigrants Ltd.). It was set up in 1949 with an initial capital of I £5 million, subscribed by the Government, the Jewish Agency, the Keren Kayemeth and semi-public Housing Corporations. The present policy of the Amidar is to use the bulk of its resources in building houses on its own account. The other part of the funds is usually utilised to facilitate and stimulate, through financial backing, similar building schemes of the local authorities and the semi-public Housing Corporations. There are many points of similarity, in respect of powers and functions, between the Amidar and the Delhi Housing Corporation. Both are

authorised to undertake direct construction as well as finance the same undertaken by other parties.

A not insignificant part of State aid in Israel comprises indirect action to foster such private activity as would eventually absorb a large number of immigrants. An example is provided by the subsidy given for a part of the wages paid by private industry to new settlers whose productivity is below the average represented by the wage-rate for the normal resident worker. No large-scale pursuit of this technique has taken place in India.

The most remarkable distinction between the approach to rehabilitation financing in the two countries seems to be that unlike in India, in Israel the Government has been, from the very start, conducting the business of resettlement as an inseparable and organic part of the more general business of promoting and financing normal economic development and construction. This was possible in Israel mainly because it was a new State awaiting development on modern lines, and the very nature of the basic economic conditions indicated that the undeveloped resources could be worked upon not by the existing population alone, but by the combined strength of the normal residents and the new settlers who, between themselves, could form something like an optimum population for Israel in the near future.

Federal Republic of West Germany*—The division of Germany into two halves, governed by opposite

* Source : Report of the Reconstruction Loan Corporation for 1950, and letter from Dr. Nowel of Institut für Weltwirtschaft an der Universität Kiel, dated 25-2-1952, Tgb—Nr.F....531 ...523/52.

socio-economic ideologies, gave rise to large movements of persons, expelled mainly for political reasons, between the two German States. As in India, the Federal Government has been carrying out refugee resettlement through relief followed by rehabilitation. The problem has been attacked on two fronts, rural and urban. A very serious problem in rehabilitation, especially in urban and industrial areas, is housing, and as in India, separate measures had to be devised for its redress. But unlike in India, financial aid to refugee enterprise is being given in the major part not by government departments but by government institutions in collaboration with the private financial organisation. The apparatus of refugee financing has been operated, like India's, on an emergency basis, under separate programmes. But the entire thing seems to be more thoroughly co-ordinated with the normal-time programme of financing general investment. This is particularly reflected in the fact that the largest burden of financing all types of business effort of both normal inhabitants and expelled persons has fallen on the Reconstruction Loan Corporation, a full-fledged government financial agency. A portion of the Federal outlay on expelled persons does not pass through the R. L. C., but is given, in part directly to the beneficiaries, in part through another important government financial agency specialising in refugee financing, namely, the Expelled Persons' Bank. A unique feature of State financial aid to refugees in W. Germany is that the central banking system indirectly facilitates rehabilitation by making funds available to the R. L. C. which the latter can use for resettlement purposes. The R. L. C. and E. P. B. require separate

discussion in view of their special significance from the standpoint of our study, and we, accordingly, propose to conclude our survey of rehabilitation financing in W. Germany with a brief account of these two specialist agencies.

The Reconstruction Loan Corporation (Kreditanstalt für Wiederaufbau) was founded in 1948 to finance the reconstruction plans of all economic branches—industry, agriculture, housing and foreign trade—handled by normal residents or refugees by opening up sources of long and medium-term credit to the extent that the needs could not be met by ordinary private agencies. This objective is fulfilled by means of medium-to-long-term mortgage loans, participations, arrangements to enable borrowing firms to raise capital elsewhere by solving the question of security through such devices as securing guarantees or assurances, and joint assistance in partnership with other institutions. Both direct and indirect forms of aid are utilised. Funds are not only lent direct to the borrowers, but also given to banks for passing over to the same. So far as refugees are concerned, the R. L. C. furnishes credit for their housing as well as for their settlement in agriculture, small industries and handicrafts, and other small investments. Housing credit for expelled persons is usually granted in the shape of first mortgage loans at 3% for periods rising up to 47 years. The R. L. C. has entrusted the task of processing comparatively smaller credit to other competent institutions and given them blocks of credit for these purposes. The loanable resources of the Corporation consist of its own share-capital owned by the

Federal Government and the Lands, foreign funds, funds granted by the Federal Government and some Federal agencies, including the central bank, and loans raised in the open market. Really speaking, the R. L. C. is more than a mere financing institution. It is virtually an instrument for carrying out by far the largest portion of the financial side of the W. German Government's investment promotion programme. Refugee financing is only one of its multitudinous functions.

The Expelled Persons' Bank (Vertriebenen—Bank A. G.), set up in Bonn in June, 1950, has been assigned the task of financing small investments of refugees without the use of R. L. C. money. It functions as the 'bank of banks' financing expelled persons. Aid is usually given through some credit institute. In exceptional cases, aid is given direct to final borrowers. On the strength of its own guarantee-fund, the Bank takes upon itself the security for credit granted to refugees by credit institutes. The beneficiaries include agriculturists. The Bank works as a supplement to the R. L. C.

The R. F. A. of India

The Rehabilitation Finance Administration was set up by the Government of India on June 1, 1948, under the Rehabilitation Finance Administration Act of 1948, with the object of giving medium-to-long-term financial aid on reasonable terms to displaced persons from East and West Pakistan "to enable them to settle in business or industry". It is an all-India agency working through branches and obtaining its funds by means of time-to-time advances from the Central Government which can-

not exceed Rs. 10 crores,* and on which the Ad. has to pay a 3% interest rate. The R. F. A. finances businessmen and industrialists whose needs exceed Rs. 5,000; smaller borrowers are accommodated under the Small Loans Scheme. The authorised methods of assistance are: making loans for fixed or working capital purposes for periods not exceeding 10 years and at not higher than 6% per year, rediscounting bills of exchange and promissory notes in respect of loans advanced to a refugee by a scheduled bank or a syndicate of banks up to an aggregate of Rs. 1 crore, and lastly, guaranteeing part of losses, not greater than 50% in a single case, which such a bank or syndicate may suffer in respect of any loan advanced to a refugee, the maximum liability under this head being Rs. 2 crores. Security and credit-worthiness are the two chief considerations in sanctioning loans.

In practice, however, the Ad. grants loans rather liberally, and grants a rebate of 1% on loans provided repayment of instalments due is made on or before due dates. Upto 1952-53 loans advanced amounted to Rs. 5.22 crores. According to data supplied by the Rehabilitation Ministry, upto the end of 1953-54, a sum of Rs. 7.72 crores "will have been" advanced by the Ad.¹⁴ The borrowers include individuals, joint Hindu families, partnerships, private limited companies, co-operatives, and joint-stock companies. No other financing technique has been employed by the Ad. so far. It has no power

* It is learnt that this limit was raised to Rs. 14 crores in mid-1952 (vide *the Hindustan Standard*, July 27, 1952).

¹⁴ Ministry of Rehabilitation, "Summary 1953-54", p. 9.

to participate in the share capital of refugee business or industry.

Points of similarity between the R. F. A., on the one hand, and the German R. L. C. and E. P. B., on the other, are neither many nor substantial. All the three are Federal public agencies. Like the R. L. C., the R. F. A. has shouldered the responsibility of financing relatively larger enterprises. But the scope of aid is much larger, and the functions and methods are more numerous in the case of the R. L. C. Unlike the R. L. C., the R. F. A. cannot assist any enterprises besides those conducted by refugees. Even within the sphere of refugee enterprise it can help only business and industry, but not agriculture or house-building. The comparison between the R. F. A. and the E. P. B. cannot also be carried very far. No doubt, both are Central agencies possessing direct as well as indirect means of assistance. But unlike the Bank, the Ad. cannot facilitate resettlement in agriculture. The major part of the Bank's business consists of indirect financing by way of guarantees to other credit institutions against possible losses, whereas the R. F. A. has not utilised the authorised methods of round-about assistance and has concentrated solely on the direct loan method in the manner of the I. F. C. of India.

Nearly the same thing will be said in a comparative study of the R. F. A. and the Pakistan R. R. F. C. The scope of the R. R. F. C. is much larger while the R. F. A.'s authorised methods of aid are more numerous. The R. R. F. C. finances rehabilitation not only in business and industry but also in agriculture and building, and

thus comes closer to the two W. German agencies than to the R. F. A. The most important point of departure between the R. F. A. and the R. R. F. C. is that whereas the former is concerned with the assistance of refugees whose needs exceed Rs. 5,000, the latter helps relatively smaller enterprises with loans which cannot exceed Rs. 5,000 generally: The R. R. F. C. is really more akin to the E. P. B. than to the R. F. A., although it was not designed to act as "the bank of banks" like the W. German institution. What is common between the R. R. F. C. and the R. F. A. is that both are Central agencies, wholly owned by the State, having jurisdiction all over the country, and intended exclusively to promote refugee resettlement with cheap and long-term credit facilities.

The Ad. has done valuable work. But the rate of interest should have been lower than at present. There is no good reason as to why this rate cannot be reduced to the same level as that of the Small Loans Scheme. Again, the Ad. has utilised only the loan method of assistance. The present writer fails to understand why other methods of aid were made available to it when it was almost certain that the Govt. was not going to land the Ad. in grave hazards which these might involve. If the administration of the Small Loans Scheme were taken out of the sphere of the State Governments and handed over to the R. F. A. along with the business of granting rural resettlement loans, better co-ordination of all assistance activities would surely have been the result, and better administrative performance in respect of all types of assistance.

An Over-all Appraisal

The administration of rehabilitation finance has revealed many defects and abuses. Nevertheless, taken as a whole, the performance of the Government affords considerable satisfaction. The task of rehabilitating refugees from W. Pakistan is now virtually accomplished. In October, 1952, the present author wrote, "Larger and better integration of refugee financing plans with those of financing normal and general economic development is desirable than now obtains. There has been too much separation of rehabilitation financing from general financing in India. Though requiring a separate, special status in the short period for technical reasons, resettlement ought to be viewed as a part of, and hence closely co-ordinated with, the long-term objective of over-all full employment."* In the first Five Year Plan, published in December 1952, rehabilitation has been regarded as "an integral part of the Five Year Plan"—"as an essential aspect of the development of the economy of the country as a whole."† The present author has, therefore, to agree to modify his old view of the rehabilitation financing organisation. The task of rehabilitation has now become a part of the greater task of providing employment opportunities to people offering their services for utilisation in increasing numbers from year to year.

* See the author's article "State Financing of Refugee Rehabilitation in India", *Indian Journal of Economics*, October, 1952.

† The First Five Year Plan, p. 649.

CHAPTER XII

CONCLUSION

Capital is both a cause and an effect of economic development. Without capital productive activity cannot be carried on, and capital, in its turn, cannot be accumulated unless there is productive activity with consequent income creation. The problem of ensuring an adequate capital supply to the private sector is, thus, only a part of the larger problem of bringing about a rise in employment and output. The financial difficulty cannot be tackled in isolation. Again, a solution of that difficulty alone will not automatically put an end to the other urgent problems of economic uplift. Further, the financial problem cannot be successfully handled unless those problems which, directly or indirectly, have a bearing on finance are efficiently dealt with. Although throughout this book we have focussed attention on finance, we cannot help concluding with the proposition that any considered plan concerning financial aid to business enterprise in India cannot but be, in essence, an organic part of a much larger plan concerning the economic welfare of the people.

So far as our thesis is concerned, we have found that for quite a long time the State has been giving financial help to private enterprise in India in several ways. In the post-war period, in the post-Independence era in particular, the volume and contents of this aid have increased significantly, and certain developments therein, like the creation of industrial development corporations

and industrial finance corporations, are likely to have far-reaching consequences upon economic development in future. Certain defects have, however, been associated with State aid. First of all, the volume of aid so far made available to private enterprise has been far below the level of adequacy. Secondly, even this limited aid has not been distributed in the best possible way. The operational efficiency of the administrative machinery in charge of almost every type of aid has been rather poor. Considerable waste of resources has also occurred, we believe, from the lack of co-ordination between the different parts of the system of assistance. Lack of co-ordination exists not only within each of the systems of aid to agriculture, industry, house-construction, refugee rehabilitation, etc., but between these different systems themselves. We wonder why this vital problem has not been touched at all by the Planning Commission in the First Five Year Plan. Rationalisation of the organisation of financial aid is long overdue. It is not impossible to effect within a comparatively short time an improvement in the quality of the administrative machinery and a change in the volume and contents of aid with an eye to the special conditions obtaining in the economy. In fact, the process of reform and construction has already been given a start. What the Indian system of governmental aid to economic enterprise needs is not only larger allocations under planned budgets, but, in addition, a spirit of adventure, supported by efficiency, without which such a mighty task as the building up of a vast under-developed country is incapable of being finished within a planned time-schedule. In course of the actual implementation of the

Second Five Year Plan, which is going to place a greater emphasis on financial assistance to private enterprise than the First, this vital consideration should not be forgotten. For, the alternative may be disaster.

