A Policy Framework for Broadbasing the Capital Market

by

James S. Raj

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The A. D. Shroff Memorial Trust

Piramal Mansion, 235, Dr. D. N. Rd.,

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THE A. D. SHROFF MEMORIAL TRUST

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(ii) Organising one or more memorial lectures annually on subjects which were of interest to the late Mr. A. D. Shroff, namely, banking, insurance, and industrial finance, the subjects to be chosen in rotation and the lectures to be delivered by persons eminent in these fields.

(iii) Awarding annual scholarship or scholarships to outstanding student or students in the field of management.

(iv) Instituting a prize to be known as The A. D. Shroff Memorial Prize for the student standing first in Banking at the Sydenham College of Commerce, Bombay.

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(vi) Without prejudice to the above charitable objects or any of them, the TRUSTEES shall have the power to spend, utilise and apply the net income and profits of the TRUST FUND for the TRUST FUND for the charitable object of education or such other objects of general public utility not involving the carrying on of any activity for profit as the Trustees may think proper, it being the intention of the SETTLOR that the income and/or corpus of the Trust Fund shall be utilised for all or any of the aforesaid charitable objects without any distinction as to caste, creed, or religion.

INTRODUCTION

The annual public lectures delivered under the auspices of the A. D. Shroff Memorial Trust on Banking, Industrial Finance and Insurance have been well received. They are by eminent authorities on the subjects in which they have specialised. In January, 1978, the Trust was fortunate in being able to arrange a lecture by an economist of vision and vast knowledge about the Capital Market, Mr. James S. Raj. His lecture was on "A Policy Framework for Broadbasing the Capital Market".

The Capital Market has an important role to play in mobilising savings, particularly of fixed income groups, for the industrial development of the country. A number of long-term measures are required to build up a healthy Capital Market. Mr. James Raj in his lecture has successfully undertaken the task of recommending a policy framework. This publication is bound to prove highly interesting and useful to policy-makers, those in financial institutions and the public. The Trustees have pleasure in presenting the text of this excellent lecture in this form.

Washington, DC — **N. A. Palkhivala**
February 17, 1978 — Chairman, Board of Trustees

A. D. SHROFF

(1899 - 1965)

A. D. Shroff's achievements in the field of business, industry and finance were many and varied. A large number of enterprises owe their origin and development to him. As an economist, his predictions have proved right over the years. Through the Forum of Free Enterprise, which he founded in 1956, as a non-political, educative organisation, he sought to educate the public on economic affairs. It was his firm conviction that a well-informed citizenry is the foundation of an enduring democracy.

George Woods, former President of the World Bank, paid the following tributes to A. D. Shroff:

> "In every age and in every society men must express anew their faith in the infinite possibilities of the human individual when he has freedom to develop his creative talents. For this is in large part how the message of freedom is passed from generation to generation. A. D. Shroff spoke eloquently in a great tradition, and thanks to him we can be sure that other great men of India will continue to speak this message in the unknown context of our future problems."

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A POLICY FRAMEWORK FOR BROADBASING THE CAPITAL MARKET

James S. Raj

I deem it a great honour to have been invited to deliver the A.D. Shroff Memorial Lecture this year, and I must express my heartfelt gratitude for it to the Memorial Trust, particularly to its eminent Chairman, Mr. N. A. Palkhivala. I had the privilege of dealing with Mr. Shroff on a few business matters many years ago when I was an official of ICICI, and I was much impressed by the sharpness of his intellect and the ease with which he grasped the implications of any investment proposal. Having had some exposure to his overall economic philosophy, which has inspired me greatly, I consider it highly appropriate that the views which I am going to put forward to this distinguished audience today will also be associated with his memory.

My involvement in capital markets, both as theorist and operator, in India and abroad, has led me to a firm belief that a broadbased and expanding capital market is absolutely essential for any developing country which has chosen a mixed economy in preference to a completely State-run one. The capital market brings together the

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Mr. James S. Raj is an eminent authority on the Capital Market. He is Chairman of Reserve Bank of India Committee on Public Sector Banks, and Dy. Chairman of Industrial Credit & Investment Corporation of India, and director of a number of companies. Among numerous posts he has held are those of the Chairman, Unit Trust of India, and Director, International Finance Corporation, an affiliate of World Bank. This is the text of the public lecture delivered under auspices of the A. D. Shroff Memorial Trust on 18th January, 1978, in Bombay.

savings of the community and the demand for capital by the units which produce goods and services. It seems to me self-evident that as an economy develops and the scale and range of the goods and services produced by it go on expanding, it will need a corresponding increase and diversification of its invested resources which of course presupposes an increase in the overall volume of savings. This proposition is independent of the relative role of the public and private sectors in the production of goods and services. Both sectors have to draw on the same pool of savings, and both depend on it for their growth.

Thus the central problem is to increase the volume of savings and also to ensure that savings flow into the capital market. Obviously, not all savings need necessarily flow into that market, since they can be embodied in durable consumption goods such as passenger cars, refrigerators and airconditioners, not to mention gold ornaments and silver vessels. Moreover, savings can be used directly by the saver for investment in productive facilities — as an agriculturist does when he digs a well or installs a pumping set — and for buying a flat or a house.

I shall try in this lecture to describe the policy framework within which the capital market functions at present. I shall examine concurrently the extent to which that framework tends to inhibit the maximum possible growth in the volume and diversity of savings flowing into the capital market, and the absorption of those savings by the public and public sector units which are engaged in the production of goods and services for the community. In the light of this examination, I shall then make some suggestions for modifying the inhibiting factors, so as to build up a more broad-based capital market.

In describing the policy framework as it exists at present, one can best conceive of it as a series of concentric circles surrounding the capital market proper. The first circle would comprise policies with respect to the money market and monetary problems generally. The next circle would consist of certain aspects of industrial policy. The last and outermost circle would be an amalgam of certain basic attitudes towards economic policy and administration. As I shall proceed to show, all these concentric layers of policy do not have the same degree of impact on the capital market, but they do set limits to what one can conceive of as a new policy framework for that market.

I would like to make it clear at this point that I do not lay the responsibility for any of what I have called "layers of policy" entirely on Government, subsuming under that term all the authorities who participate in the decision-making process with respect to the capital market. Even an omniscient and omnipotent Government has to take into account what the public will put up with, and at what stage it will get restive and revolt. Economic policy is not made in a vacuum.

For purposes of exposition, I shall start with the outermost layer of policy and work through the others till the central core of policy with respect to the capital market is reached.

Taking up for analysis basic attitudes towards economic policy and administration first, the striking thing about our country is the all-pervading mistrust of the market mechanism, and the firm belief that all prices can be controlled by administrative fiat. As a very senior economic administrator once put it to me, the market mechanism merely means rationing by the purse instead of by need, and prices can and should be

controlled by administrative action so that the basic goods and services can be made available to the public by rationing if necessary. Both our authorities and our public share these beliefs, so that there is not much point in trying to alter the policies which flow from them. As a matter of passing interest, however, neither the Soviet Union, which in addition to comprehensive rationing arrangements runs shops where scarce goods are sold at what we would consider black market prices, nor most Latin American countries, which make perfunctory attempts to control prices but rely more on increasing incomes by inflation to enable to pay higher and higher prices, subscribe to our creed.

The operative significance for the capital market of the mistrust of the market mechanism and the firm belief in price controls is two-fold. Firstly, in the foreseeable future we have to take it for granted that commodities which by some stretch of the imagination can be deemed to affect the cost of living will be subject to price controls and that prices will be allowed to fluctuate freely only in very peripheral sectors of the economy which mostly cater to the affluent classes, subject of course to excise duties which will rake off most of the profits for the exchequer. Hence investment in the equity shares of practically all industries will have an element of chance built into them. Secondly, affecting the capital market directly, the fact that the prices of equity shares with growth potential show spectacular rises now and then will be viewed with deep suspicion and attempts will be made to dampen them down by dividend limitation, which indeed is a plank in the Janata Party's economic policy.

Although I am generally of the view that people will only believe what they want to believe,

I cannot refrain from making a few remarks on dividend limitation. If dividend limitation is imposed, the only people affected are those who hold high-dividend shares at that particular moment of time. Some of them may have bought the shares only a little while earlier at a considerably higher price than the face value, so that a dividend limited to say even 15% of face value may end up as a 5% yield. Moreover, not all such persons caught by the music having stopped are necessarily bloated capitalists. Leftists may find this hard to believe, but quite a large number are middle-class people, including the proverbial widows and orphans. As an aside, I have been trying for many years to convince my sophisticated stock market friends that they would do well to agitate for putting all equity shares on a "no par value" basis, so that dividend rates would reflect the true returns on a share, but they have never reacted favourably to my suggestion.

I now come to the next set of policies, namely those relating to industries. There is now a new industrial policy which lays greater emphasis on small-scale industries and the so-called "tiny sector", but since these sectors of industry rarely draw on the capital market for their needs, they may not affect the demand for funds in that market to any significant extent. A single fertilizer project which might cost Rs. 150 crores to set up under present circumstances is equivalent to literally thousands of small-scale and "tiny" units. It is, therefore, industrial policy towards the large and medium units which counts as far as the capital market is concerned.

The first and foremost aspect of industrial policy which has a bearing on the capital market is the extent to which the public sector will be encouraged to grow either by nationalization and

management take-overs by Government of existing concerns, or by the establishment of new public sector units. The past record of nationalization and management take-overs has not been such as to enthuse the affected shareholders and creditors. When banks were nationalized in 1969, reasonable compensation was awarded to the shareholders. In certain cases, mergers of the residuary banking companies with industrial companies even led to an improvement in the position of the erstwhile bank shareholders. By way of contrast, the shareholders of Indian Iron, after its management was taken over, have suffered just as much as from an inefficiently run private sector company. In the nationalization of coal companies, compensation was assessed on such a basis as to result in considerable losses to shareholders. No wonder any investor who has his money in equity shares begins to worry as to what might happen to him in case the concerns are nationalized. At every annual general meeting of electricity-generating and distributing companies there are any number of anxious shareholders who ask the question as to what would be their fate if the concern were to be nationalized. No Chairman is ever able to give a satisfactory answer except to express the pious hope that nothing may happen.

The establishment of new public sector units is also bound to be undertaken on an increasing scale. The West Bengal Government, after a brief period of discussion with the larger Indian industrial houses as well as multi-nationals, seems to have now decided to opt for a spectacular growth of the public sector, involving around Rs. 300 crores of investments. The production of LPG from Bombay High and new public sector fertilizer units, which the Central Government is interested in, will absorb several hundred crores of

Rupees as project costs. Nothing on these spectacular lines is in the offing in the private sector so far as new projects are concerned, although FERA companies which are bringing down the foreign percentage holding by issuing additional equity capital will generate some new investment. The overall effect on the capital market will be that there will be a considerable draft on the funds flowing into it, but largely for the use of the public sector.

I have already referred to price controls. Apart from the motivation of controlling the prices of articles of mass consumption, price controls will also continue in order to provide Government with essential inputs for building up its public sector units so as to limit the budgetary costs of such projects. Hence price controls on cement and steel are bound to continue. In order to reconcile this system with the need for the financial viability of such industries, in which the public sector now has a large stake, there will probably be a considerable extension of the dual pricing mechanism. I am sure our Government economists will devise many refined variants of this system — differentiation between old and new units, geographical discrimination, variations in the proportion of output going to the free market etc. As this audience is surely aware, the dual pricing mechanism has some other advantages also, from the point of view of the management groups which run the units concerned.

There are many other aspects of policy relating to industry, notably pertaining to management — employee relations and the nexus between wages and productivity, which have an important bearing on the growth of industries and their productivity, which in turn affect the growth of industries and their profitability. I am deliberately

refraining from dealing with such matters in this lecture, not because they are unimportant, but because they affect not only the capital market, but the future course of our entire economy. Moreover, the whole subject of the contribution of labour to industrial growth and profitability has political overtones which I have no competence or desire to deal with.

I now come to the layer of policy which is only one remove from the capital market proper, the money market and monetary policy in general. The central plank of monetary policy will, I think, continue to be anti-inflationary because our urban public gets frightened at even a 20% annual rise in prices, which Latin Americans take in their stride. Anyone who saw the **morchas** and demonstrations in Bombay and Calcutta in February — March 1974 would appreciate what I mean. Since the tradition among our economists is to contain inflation mainly by restraining aggregate monetary demand, we may expect a continuance of tight money conditions, high interest rates and impounding of additional incomes.

Having dealt with the outer layers of economic, industrial and monetary policies which affect the capital market I now come to the policy framework within which the capital market proper currently operates. On the demand side, the constraints are very clear-cut. So far as the private sector is concerned, before any significant issue of capital can be made, be it in the form of debentures, preference shares or equity shares, the amount, terms and timing have to satisfy the Controller of Capital Issues. It is not necessary to spell out to this audience the detailed regulations in this regard. I am neglecting in this connection the loans granted by long-term financial institutions for project finance, because these loans are

not negotiable instruments except to the extent that participation certificates based on them are created by the banks and marketed in large blocks. As regards Governmental and public sector demand for capital, this again is subject to various constraints in which the Planning Commission, the administrative Ministry concerned and the Finance Ministry all have a say. The fundamental basis of these constraints is that capital being scarce, access to the capital market should only be permitted on some judgment by Government as to how much of it and on what terms such access should be allowed.

On the supply side the position is more complex. Obviously the supply of capital, except to the extent that Government generates surpluses in the course of its operations, depends on the savings of individuals. Since Government makes the largest draft on the national resources for capital, the result is that current capital market policies have been framed essentially to attract from the public the required amounts of funds to be pre-emptively channelled to the public sector. The method by which this is done is to attract funds to banks, financial institutions and Provident Funds, and to make sure that these in turn are under obligation to invest a specified minimum percentage of these funds in securities designated by Government. Following the nationalization of the bulk of the banking system in 1969, a specified portion of their deposit liabilities (currently 33%) has to be invested in Central and State Government securities. This has led to an enormous increase in the availability of funds to the Government at slightly less than 6% interest. There are also other large institutions, of which the Life Insurance Corporation is the prime example, which are under obligation to invest a sizeable proportion of their accruing

funds in Government securities. The same is the position with respect to Provident Funds.

The result of this captive supply of capital to Government is that there is now a considerable hiatus between the interest rates on Government securities and the interest rates on industrial debentures. I am not pretending that unguaranteed debentures are as safe as Government loans, but surely it is untenable to claim that in the present conditions a negotiable 10½% debenture issued by a Tata or Mafatlal company is so much more risky than a Government loan that there has to be a differential of 4½% in the interest rate. When I once asked a former Governor of the Reserve Bank about the rationale of this kind of differential, he informed me that since most Government projects do not even make 5% on their capital employed, Government could not afford to pay more than 6%. The other argument he put forward was that any increase in the rate of interest on Government loans would lead to depreciation of their value and involve the institutions which hold them in considerable accounting losses. These are valid arguments up to a point.

The other policy constraint which affects the supply of capital going into any negotiable financial instrument other than Government securities relates to the taxation policy on the income and wealth derived from such instruments. Except for certain favoured investments such as units of the Unit Trust of India, which at one remove really constitute a mix of debentures, preference share and equity shares, the taxation policy is loaded against equity shares. While every effort is made to attract savings by increasing the rate of interest on debentures and pushing up the dividend rate on preference shares, the return on equity shares

even notionally is considered as rating only 1% above the return on preference shares. Any investor, big or small, has to contend with deduction of tax at source on the dividend from equity shares. This of course applies to preference shares and debentures also. But it does not apply to interest on bank deposits or units of the Unit Trust of India. Moreover, the liquidity of equity shares is impaired by regulations governing the period up to which they must be held to qualify for capital gains tax rather than income-tax. A subscriber to a new equity share which may take several years to yield any dividend is given no incentive whatsoever by way of tax concessions. The list of disincentives is long and there is no point in repeating them here.

I have often tried to probe as to why there is this remarkable antipathy towards equity shares not only on the part of the authorities but also the non-investing general public. The impression I have got is that most of this antipathy is due to the feeling that since control of companies depends on the voting strength conferred by equity shares it is only the large and powerful families which are interested in increasing the return from them. This is of course only partly the truth, and I know of many cases where members of the families of large houses make every effort to bring down the prices of the share on the crucial date for preparing their wealth tax returns. Moreover, anybody who thinks that it is only the return on their equity shareholding which motivates the large houses to try to control companies is barking up the wrong tree. There are many other ways of shaking a company pagoda tree.

In the context of the policies towards the capital market that are in existence it is

no wonder that the market is in complete disarray. New issues of equity shares of new companies hardly ever succeed in the market, and invariably the financial institutions which have underwritten them are landed with almost the entire issue. Non-growth companies with steady profits and dividends such as Ahmedabad Electric, ICICI, ACC and East-India Hotels and many of the tea companies are having their shares quoted on more than 12% dividend yield basis. FERA companies which for the purpose of bringing down foreign shareholding to less than 40% issue additional shares at a price considerably below the market quotation are finding it difficult to get their issues subscribed. The general public seems to be gradually coming to the conclusion that rather than taking any undue risk it is better to be prudent and stay on more than 12% basis even for companies with growth prospects. The fact that many growth companies are only on an average 5% dividend yield basis, as for example Larsen & Toubro, TELCO, Century Enka, CAFI, etc. does not mean much because there is always a group of investors who are interested in growth for purposes of income several years hence and their chances of getting this type of share are constantly thwarted by the fact that the public financial institutions are gradually soaking up the equity shares of such companies. Hence there is the phenomenon of too much money chasing too few attractive shares.

If the market goes on like this the day will come when institutions will not only be getting possession of the bulk of the existing attractive shares but will also come to control most of the companies concerned due to their right to convert part of their loans into equity. The shareholding public will therefore shrink perhaps not in

absolute size but certainly relatively to the institutions. At the present time the managements of companies with a good track record of profits and dividends seem to have reconciled themselves to this state of affairs because the control which a well-informed and vigilant body of small shareholders exercises over them is replaced by desultory and spasmodic discussions with middle-level officers of the public financial institutions, interspersed with being nice to some of the nominee Directors of these institutions. The stockbroking community has also turned its attention away from equities to company deposits, financial advice and switches of Government securities.

I personally believe that if this state of affairs is allowed to continue for some time it will completely destroy whatever standing the equity market enjoys in our economic scene. But the situation has deteriorated so badly that it is now a question of getting at the roots of the present malaise and not merely one of a tax concession here or a development rebate there. I think the first order of business is for Government to take a policy decision that it will fix the policy framework in such a manner that direct investments, be it in debentures, preference shares or equities regain their attractiveness as contrasted with bank deposits, LIC policies and subscriptions to Provident Funds which transfer larger and larger sums to the control of monolithic financial institutions.

It is, of course, open to Government to decide that it wants to centralise the bulk of investment decisions in its own hands and in effect to separate the saving decision from the investment decision, in other words to go on in much the same way as hitherto. But it is my firm belief that the total volume of savings can be considerably increased

only if opportunities are created for the saving decision and the investment decision to be simultaneously taken by individual savers. One can never prove a statement of this kind but there are certain straws in the wind. Savers in the rural sector are notoriously conservative, but they have shown their willingness to invest in equity shares of such companies as Indian Explosives and Mangalore Fertilizers when stockbrokers took the trouble to go to their areas and explain the benefits they would get from the setting up of fertilizer projects there. The Unit Trust is getting good response to its efforts to sell units in the rural areas although the concept of units is extremely difficult to grasp for an unsophisticated investor. The mere fact that direct investment in agriculture by way of improvement in the production facilities of farms has gone up by leaps and bounds as proved by the sales of pumping sets and tractors is a pointer to the fact that when there is a tangible asset to be seen at the end of an investment decision the rural public will increase its savings.

To my mind we have strayed considerably from following a path which will lead to savings, preferring instead a consumer-oriented society. Business firms and manufacturers who originally operated in a competitive market have over the years through sophisticated market techniques succeeded in creating a sellers' market for their products. The lesson which we can derive from this is that instead of building up a consumption-oriented society which we can ill afford we should build up a savings-oriented society, using the same methods of marketing to popularise savings. This is the only sure way of stepping up our economic growth rate. But savings from the public will not increase and flow into the capital market unless there is created the confidence that the investing

public can have a real control over the resources which they have saved.

Assuming that a more broadly-based capital market would be a desirable objective, what are the modifications of the policies affecting that market, either proximately or directly? To this question, I now address myself.

With regard to the fundamental basis of economic policy, that is to say mistrust of the market mechanism and the belief in price controls, no significant modifications are possible, but it is to be hoped that the manifestation of this attitude in the form of dividend limitation will at least disappear. I have already explained why dividend limitation is a bad idea; in any case, the equity shareholders bear the brunt of risk in any company, and it is essentially unfair to them to limit the return on equity shares. The higher the risk, the higher the reward. No one blames an air hostess for making ten times the salary of a school teacher, although both may have the same educational qualifications.

It is in the next layer of policy, that relating to industry, that I believe considerable modifications are desirable and possible. I refer especially to the policies which govern the rehabilitation of sick units, which at present generally get taken over by Government and go on making losses at the expense of the exchequer. To anyone who is familiar with the systems operating in other countries, what is striking in this sort of Government action is the inexplicable unwillingness to differentiate between the financial sickness of a company and the physical health of its assets. In many Latin American countries, for example, there is a rule that as soon as the equity capital of a company has been eroded by more than

50 per cent, that company should be compulsorily put into liquidation by the Company Law authorities. This does not mean that the plant comes to a stop or that workers lose their jobs. As soon as the company is put into liquidation, efforts are made to sell it as a going concern to some other industrialist, who then puts up a financial reorganization scheme whereby the present bondholders and equity shareholders are made to scale down their financial rights and relative preferential positions. Usually, within a few months the plants are working again with their financial burdens written down under new managements with a stake in the concern. In our country, however, in case after case we find that nothing is done about the financial reorganization of the company — except to the feeble extent of some banks agreeing to scale down their accumulated interest — and the concerns go on with the basic capital structure unaltered and with management which is an uneasy compromise between the old and the new. Instead of taking on such financial burdens it would be far better for Government to sell the concern to a financial or industrial group, making sure that in any financial reorganization the interest of the workers will not suffer.

The public sector can grow, not only by the takeover of existing privately owned companies, but also by the promotion of new projects. In this context also, there is nothing to prevent directing such projects much more to the capital market. Some years ago, Scooters India raised equity capital in the market. The Damodar Valley Corporation raised several crores of Rupees through unguaranteed debentures with a 10½% coupon rate. So did SICOM in Maharashtra. This kind of development can be fostered to a greater extent, without in any way jeopardising the

control of Government over the companies or statutory corporations in question. As long as Government controls over 75% of the equity capital, the other shareholders can only expect a financial return on their investment, as the 8% minority shareholders of the State Bank of India do, but their presence will have a healthy effect on the management. In fact, Government can consider marketing a minority equity shareholding in many of their successful concerns such as Shipping Corporation of India, State Trading Corporation and Hindustan Teleprinters. If the premiums on such shares are set as attractively as in the case of FERA companies, and the offers of sale are handled by experienced stockbrokers, quite considerable funds can flow into Government's coffers and be utilised for financing new projects.

On price controls and dual pricing policies, intelligent manipulation can confer financial health on the companies affected by such policies. Without giving up the basic policies, Government can easily streamline their administration so that the necessary changes in controlled prices and the proportion of the output allowed to be sold in the free market are effected expeditiously. This will contribute to making investment in such units attractive.

As regards monetary policy, it would be undesirable to make any fundamental changes in the present anti-inflationary policy. This is because without a stable currency which maintains its value over time, it is meaningless for people to be asked to save. However, an anti-inflationary policy is quite consistent with a lowering of the interest rate structure, provided credit is rationed and Government does not rely unduly on deficit financing. There are of course inflationary pressures emanating from the generation of

balance of payments surpluses which will also have to be contained, and one way of containing them would be to channel inflow from abroad into portfolio investment, at least by non-resident Indians and aliens of racially Indian origin. In any case, the lowering of the interest rate structure, despite other difficulties such as the adverse effect on the profitability of banks and long-term financial institutions, is at least a desirable long-term objective. In a stable monetary situation like the present, the growth of industry will benefit considerably from such a reduction. This may also pave the way for slowly bridging the gap between the interest rates on Government loans and non-Government debt instruments, which might even lead to a revival of public interest in subscribing to Government loans.

On policy relating to the capital market proper, a number of detailed suggestions have been made by stockbrokers and other experts. Most of them are intended to improve the return on equity shares and to enhance the chances of issue of bonus shares. All these measures will no doubt be helpful, but the main modification of policy required to increase the volume of savings flowing into the capital market is to keep in view the importance of combining the savings decision and the investment decision, so as to give individual savers a stake in their investments. The suggestions which are made here stem from this basic objective.

As recommended by the Study Group on Term Loan Participation Arrangements under the Chairmanship of Mr. K. N. R. Ramanujam some years ago, term lending institutions can issue participation certificates directly to the public in denominations of say multiples of Rs. 1,000/-, instead of leaving it to the banks to issue them in large denominations and to market them among

themselves. Suitable measures may also be taken to impart a degree of liquidity to these instruments to enhance their marketability. In fact, there are many other ways in which financial intermediaries can develop suitable financial instruments with different mixes of return, risk and liquidity.

On the same theme of mobilising savings for direct investment there is an important lacuna in our country as far as the provision of housing finance is concerned. It may be recalled that the Saraiya Commission in 1972 had noted that there are no country-wide institutions which combine regular savings schemes with the provision of housing finance in adequate amounts and on reasonable terms. A beginning in filling up this gap is being made by ICICI through its recently established Housing Finance Corporation, thanks to the energetic and persistent efforts of Mr. H. T. Parekh during the last few years in the face of many discouragements and disappointments. It is to be hoped that steps will also be taken to create and develop a secondary mortgage market and to impart liquidity to housing loans so that the Housing Finance Corporation will have a reasonable chance of success.

Above all, however, there is no real substitute for making investments in the form of equities attractive to the saver and to provide a market for their conversion to cash when required. Here the role of stock exchanges is extremely important. By and large, however, the stock exchange fraternity has not been noticeably enthusiastic about educating the public regarding the nature and characteristics of equity shares and creating a broad market for them. In the conditions of the present time, most brokers are far more interested in making a fractional percentage turn on a few

crores of Rupees of Government loan switches every few days than in developing a market for equity shares among the middle classes. Also let us not forget that it is far more easy to make a few thousand Rupees on one speculative deal in the forward market — which exists although it is banned.

This brings me to the subject of reform of the stock exchanges. Among many middle class people, particularly the intellectuals teaching in the universities, I have found complete disgust about the way stock exchanges are functioning. Much of this attitude stems from pure ignorance, but when phrases like "Den of Thieves", "Speculators' Paradise", "Gamblers' Heaven", etc. are used by intellectuals to describe the stock exchanges, there is evidently some communication gap somewhere. There is, of course, no question that several kinds of malpractices do exist in regard to share dealings. It is surprising for example that no serious steps have been taken in regard to insider dealings on our stock exchanges. I think the time has come to consider how best to imbue the public with some confidence in the working of these bodies and to spread more knowledge about what is now a highly esoteric business.

The end product of the policy framework which has been suggested here, consisting of modifications of the policies which affect the capital market both proximately and directly, will be a considerable increase in the overall transactions in that market. In the process, the dependence of Government on pre-empting funds which would otherwise flow to the capital market will be considerably reduced, but public sector units, instead of depending on direct contributions by Government or the public financial institutions,

will be able to tap the market for their needs. The private sector will be in a position to create greater confidence in its future growth and profitability and will attract more direct investment by the public, instead of having to go cap in hand to the public financial institutions. Since the demand for investment in a growing economy is practically unlimited there will be a great increase in the overall volume of negotiable financial instruments, and a broadening and diversification of such instruments. The number of private savers-cum-investors will increase, and they will become more and more knowledgeable about the statutory corporations and Government and non-Government companies in which they have invested, taking an intelligent and alert interest in their affairs.

Our voting masses who are generally believed to be ill-informed and swayed by irrational considerations restored political democracy in our country in a spectacular turnabout less than a year ago. It is now up to our economic and administrative elite, led by our statesmen, to follow up with the restoration of economic democracy, of which a broadbased and diversified capital market is an essential component.