Bank Finance for Industry

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The role which the Indian banking system will be expected to play in the expanding economy of the country during the Second Plan period offers an interesting and useful line of study,

Under the impetus of the Plan the working capital requirements of private industry will steadily increase, and the banking system will be expected to meet the requirements with the assistance, if necessary, of the Reserve Bank of India.

Bui the question is how far bank finance will be adequate for the increased need of industry.

From the analysis presented below it will be clear that an institutional gap would inevitably emerge if the. deposit expansion of the order of at least Rs 500 *crores did not take place during the Second Plan period or advances to other than the industrial sector were required to be greater.*

As the Second Plan gets into stride import surpluses are likely to be larger and produce a greater contractionist effect. In the circumstances there should not be any complacency about the adequacy of bank finance during the Plan period and measures would have to be adopted to introduce greater flexibility in the supply of credit and, if necessary, to reorganise the entire credit machinery.

(All references have been given at the end of the article).

BEFORE we examine the question of adequacy of bank finance for private industry during the Second Plan period, it may be worthwhile to recapitulate the experience in this connection during the First Plan period. In respect of the provision of working capital requirements to trade and industry during the First Plan, the performance of the Indian banking system has been on the whole satisfactory. The Plan's estimate was that Rs 158 crores would be forthcoming from banks and other sources of short term finance to meet industry's needs of working capital. It might be presumed that the banking system was expected to provide by far the greater portion of it.

In the five years from December 1950 to December 1955, the scheduled banks' advances to industry rose from Rs 152.36 crores to Rs 221.0 crores, that is, by Rs 69 crores nearly; and commercial advances rose from Rs 246.13 crores to Rs 323.2 crores or by Rs 77 crores. About the time the Plan estimates were framed, the volume of credit itself had been at an inflated level which was substantially curbed by the restrictive monetary policy of November 1951. It was in subsequent years that under the stimulus of the industrial and general economic expansion, an increase in the demand for credit took place.

Advances to industry indeed rose from Rs 196 crores at the .beginning of the First Five Year Plan (March 1951) to Rs 279 crores at the end of the First Five Year Plan (March 1951). Thus there was a rise of 42 per cent in industrial advances during these five years. In the circumstances the assistance provided by the banking system in India was not inadequate.[2]

A study of the Reserve Bank of Indian Research Department estimates that the working capital requirements of industry that may have to be provided by the banking system would amount to an additional sum of about Rs 150 crores during the Second Plan period. This study is based on capital-sales ratios and the assumption that the level of borrowing would continue to be 60 per cent of the inventories as estimated by the Taxation Enquiry Commission and that the share of bank finance in the level of borrowings would rise to about one-half. That is, in addition to the current provision of industrial credit of Rs 180 crores Rs 220 crores which constitutes nearly one-third of total bank credit, the banking system would be called upon to provide a further amount of Rs 150 crores to industry.[3] Assuming that there will be no change in the present institutional framework, an increase in bank credit to industry could come about either through an expansion of the banks' resources or through, a readjustment of the banks' assets portfolio.

The question of expansion of the banks' resources is closely related to the trends in bank deposits. The declining trend in deposits witnessed in the immediate post-war years has been reversed, and from 1952 it appeared that a phase of deposit expansion had definitely set in. From Rs 823.5 crores in 1952 the deposits of all scheduled banks rose to Rs 1,013.4 crores in 1955. In the twelve months of 1955 the increase was by nearly Rs 87 crores. With the increasing tempo of economic development, the level of deposits may be expected to go up. The extent to which the level will rise is related to the trends in money supply which again will chiefly depend on the scale of deficit financing. According to the estimate of the Research Department of the Reserve Bank, two-fifths (40 per cent) to one-half (50 per cent) of the increase in money supply is expected to take the form of deposit money. But in view of the recent trends in the composition of money supply not only in India but also in other countries, it will be misleading to suggest that the deposit component of the increased money supply would form such a large proportion. According to the Report of the Central Board of Directors, Reserve Bank of India, of the increase in money supply during 1955-56, expansion in currency accounted for 4 |5ths.[r] In exact figures currency constituted 73.3 per cent of the total expansion in money supply which was an increase from 65.0 per cent in the previous year.a In almost every country a similar trend is being witnessed for the currency component to increase relatively to the deposit component of the money supply. In the circumstances it will be nearer the mark to believe that one-third to one-quarter of the expansion in money supply would take the form of deposit money.

In the light of our past experience of the impact of deficit financing on money supply during war years and during 1953-55, and taking account of the deficit in the balance of pay-

*Total advances of Scheduled Banks to Industry (Rs crores): Dec. 31, 1952: 178.8; Dec. 31, 1954: 199.9; Dec. 31, 1955: 221.0.

ments and the possible absorption of money by the Reserve Bank through open market sales on the one hand, and the volume of credit creation by the banking system on the other, deficit financing of the order of Rs 1000 crores (another Rs 200 crores being met by drawing down Sterling balances) may be estimated to produce a net increase of money supply to the extent of Rs 1500 -Rs 1600 crores. On the basis of the ratios between currency and deposit money as prevalent in recent years, it may be assumed that the increase in deposits would amount to Rs 400- Rs 500 crores.

Advances of the scheduled banks in India in 1955 accounted for nearly Rs 650 crores out of total deposits of Rs 1000 crores. This works out to an advances-deposits ratio of about 60 per cent. If the same ratio is maintained and if it is assumed that industrial credit would account for half the credit expansion, a rise in industrial advances of the order of Rs 150 crores would postulate an increase in total deposit liabilities of Rs 500 crores. Thus without a redistribution of the assets portfolio, the scheduled banks would be Just able to meet the increased demand for credit. In the event of the demand for commercial and other types of credit Increasing by more than Rs 150 crores, the maintenance of a 60 per cent advances-deposits ratio would call for an expansion of deposits by more than Rs 500 crores. In case the deposits do not increase by more than Rs 500 crores, the increased demand for credit can be met by pushing up the advances-deposits ratio. A rise in this ratio would mean a corresponding reduction in the ratios of cash and or investments to deposits. The problem, therefore, resolves' into that, first, of how far the banks can lower their cash ratios and work with safety and unimpaired liquidity; and secondly, how far they can reduce their investments without repurcussions on the gilt-edged market.

Cash Ratio

While the ratio of loans and advances, including bills discounted, to deposits In recent years (1954-55) has hovered round about 36-37 per cent in the U K and 38 per cent in the U S A, that in japan has been as high as 79.2 per cent and in Western Germany as high as 90.8 per cent But in the context of the inflationary potential inherent in the large scale development expenditure under the Second Five Year Plan, the pushing up of the advpnees-deposlta ratio much too high would not be desirable. The ratio has recently soared above 70 per cent under the pressure of a continued demand for bank credit. Efforts should be made to keep it Within a range of 60-65 per cent.

The raising of the advances-deposits ratio would have to be at the Expense of the cash ratio. Even if the lowering of the cash ratio were feasible under the present conditions of greater availability of Reserve Bank credit and liberalized remittance facilities, the scope for reduction is limited. The cash ratios, have already been pushed much below the levels at which they were maintained in the pre-war or early post-war years. In 1954-55 the ratio of the scheduled banks' cash and balances with the Reserve Bank to deposits was 9.50 per cent and in 1955-58 it was still lower at 8.69 per cent In January 1957 It touched a low of 7.64 per cent.[3] When the British banks with their long established traditions and functioning in a highly organised short term money market are working with a ratio of about 8 per cent, it will be clearly undesirable for the banks in India to reduce their cash ratios still further. Moreover, the excess of balances with the Reserve Bank over the statutory minimum during the last three years of 1953-54, 1954-55 and 1955-56 have amounted respectively to Rs 11.94 crores, Rs 18.89 crores and Rs 13.93 crores.[0] It is clear they do not provide an adequate basis for expansion of bank credit to any significant extent

To what extent would it be feasible to reduce the banks' holdings of Government securities from the present level? The ratios of the investments of the scheduled banks in Government securities to their net liabilities have varied between 35-38 per cent during 1951-52 to 1955-5G. The ratio though closely similar to that of the London clearing banks (which was 35 per cent in January 1955) is indeed higher than in some other countries. But the scope for reduction of the investments-deposits ratio is not very great. During the Second Plan period, the banking system will be called upon to take up large blocks of Government loan issues. Unles3 the Reserve Bank stands ready to purchase all the securities that the banks may throw upon the market to release funds for advances to trade and industry, the banks may be unwilling to sell them at a loss. If they have to sell some of their investments at all to meet the legitimate credit demands of their customers, who are their bread and butter, and have to realize capital losses, the rates charged to customers may be raised to compensate for these losses. Large sales of securities will also lead to a fall In security prices and a rise in open market interest rates which again will raise customers' rates. Large scale liquidation of Investments without support from the Reserve Bank would cause a great deal of confusion and instability in the Government bond market Even If the support of the Reserve Bank were available and the Bank engaged in open market purchase operations on a large scale, the inflationary pressures inherent in the enormous development expenditure would be considerably aggravated.

The banks, however, need not be required to sell out their Investments for increasing their advances to trade and industry. They can always obtain the necessary resources by borrowing from the Reserve Bank against the pledge of Government securities. The declared policy of the Reserve Bank is to make its credit available against the pledge of such securities. But a great deal will depend on the terms on which such credit is provided by the Reserve Bank.

Other Resources

. Another source from which the banks could secure the necessary funds for increased advances is their capital and reserves which would have to be expanded. If an expansion of the risk assets of the banking system has to take place within a given volume of deposits and within a given framework of cash and investments ratios, it would have to be accompanied by an expansion of capital and reserves. But the Indian banks have shown no tendency towards increasing their capital and reserves. The ratio of paid-up capital and reserves of the cheduled banks to deposits stood constant at 9 per cent during 1950-53 and declined to 8 per cent in 1954 and 7 per cent in 1955.[10]

It is clear from the above analysis that an institutional gap would inevitably emerge if the deposit expansion of the order of at least Rs 500 crores did not take place during the Second Plan period or advances to other than the industrial sector were required to be greater. As the Second Plan gets into stride, import surpluses are likely to be larger and produce a, greater contractionist effect. In the circumstances there should not be any complacency about the adequacy of bank finance during the Plan period and measures would have to be adopted to introduce greater flexibility in the supply of credit and, if necessary, to reorganise the entire credit machinery.

Rising Time Deposits

There is, however, an interesting trend in the behaviour of bank deposits In recent years which may enable the banking system to increase their loans and advances to trade and industry on the basis of its existing resources. Since 1951-52 a remarkable shift in favour of time deposits as against demand deposits can be witnessed. The percentage of the scheduled banks' demand deposits to total deposits has been steadily declining while that of time deposits to total deposits has been steadily increasing. The former stood at 67.1 percent in 1951-52 but declined continuously till it reached 59,9 per cent in 1955-56, while the latter rose from 28.50 per cent to 34.39 per cent. The table given below clearly brings out the unmistakable trend towards time deposits.

This trend is rather curious in the context of the expanding economy of the country. It docs not conform to the general behaviour pattern of bank deposits during such periods. It may be partly due to the liquidation of real property as a result of legislative and fiscal measures. But this is largely due to the general rise in deposit rates induced by the Exchange Banks' competition for funds in the Indian money market now that the cost of borrowing in the London market has increased. Whatever repurcussions the trend may produce, there is one redeeming feature. With the growing percentage of time deposits to total deposits, the power of the banking system to create credit will tend to increase. A lower cash

All Scheduled Banks[11]
(In crores of Rupees)

	Demand	Time	Savings	% of time liabilities to total liabilities	% of demand liabilities to total liabilities
1951-52	593.73	290.82	135.66	28.50	67.1
1952-53	546.23	309.26	138.05	31.12	63.8
1953-54	526.75	328.26	142.14	32.91	61.6
1954-55	559.62	351.86	151.57	33.09	61.4
1955-56	608.64	407.95	169.40	34.39	59.9

ratio has to be maintaied against such deposits and funds may be released from required reserves for loans and advances.

Compulsory Deposits

Against this potential increase In the power of the banking system to create credit and thereby increase its advances to industry must be set the far reaching effects of the recent fiscal measures relating to control of depreciation and other reserves upon the capacity of self-financing on the part of industry. Depreciation allowances and development rebates normally deducted for purposes of computation of profits would no longer be treated as items of expenditure unless the companies deposit with the Central Government or Reserve Bank before June 30 of the relevant assessment year a prescribed amount depending on its undistributed profits and reserves. The amount to be so deposited will consist of two parts (1) one part being a certain percentage of the amount by which the retained profits of the previous year available before deduction of depreciaties and development rebate but after deduction of income and super tax payable and dividends declared exceeds the sum of one lakh of rupees. (2) the other part being a prescribed percentage of accumulated profits and reserves which are not represented by fixed assets in the business.

Such a scheme of compulsory deposits of a portion of the accumulated profits and reserves of industrial companies will oblige them to take recourse to the banking system for that part of their current finance which they were providing themselves out of their own liquid resources. At a time when the banks are already fully loaned up, this additional demand for accommodation will put them under a severe strain. The deposits are no doubt refundable wholly or partly In such cases where; the Government is satisfied that the refunded amount will be used in business for "approved" purpose. But it Is well-known it will mean a tremendous delay *to* obtain the Government's approval for release of funds and many inquisitorial enquiries may have to be faced the circumstance the industrial concerns will prefer to rely on the banking system.

Changing Character of Deposits

Recent developments during the busy season of October 1955—March 1956 have highlighted *this* problem of adequacy of bank credit. During March 1956 there was a net rise of scheduled bank credit by Rs 64.1 crores as compared with Rs 25.8 crores in March 1955. The expansion during the busy season (October 15, 1955 to March 30, 1956) amounted to Rs 172.4 crores as against Rs 97.5 crores in the preceding season (October 1954-Mar.ch 1955). A significant feature of- this rising; trend of bank advances is that it has not been accompanied by a sizeable increase In the resources of the banking system'. The net deposit liabilities of the scheduled banks increased from Rs 899.42 crores in 1954-55 to Rs 1003.54 crores only in 1955-56. In January 1957 they reached Rs 1110.30 crores. Not only the rate of increase of deposits has been slow, but the increasing trend has not also been uninterrupted.

The monthly break-downs of deposit figures reveal declines of deposits in several individual months. In February 1956 net deposit liabilities fell by Rs 2.03 crores to Rs 1037.29 crores from Ra 1039.32 crores in January 1956. In March 1956 again they fell by Rs 7.79 crorea to Rs 1029.50 crores as compared with the previous month. As a result the advances-deposits ratio shot up from 67.0 per cent at the end of February 1956 to 73.0 per cent in March 1956. The increased demand for credit is being met by the banks through borrowings from the Reserve Bank, by drawing down their cash reserves and by selling out their investments. Their net borrowings from the Reserve Bank rose by Rs 24.3 crores to Rs 65.1 crores as against the rise of only Rs 11.5 crores in the preceding month and their investments in Government securities fell by Rs 15.4 crores as against Rs 8.1 crores in March 1955.

The investments-deposits ratio declined from 36.2 per cent at the end of March 1955 to 34.2 per cent. The cash ratio also declined from 8.4 per cent in March 1955 to 8.1 per cent in March 1956. It Is interesting to notice in this connection that the commercial banks in the USA have been recently faced with a persistent heavy demand for funds from the private sector. The banks are meeting the increased demand for credit by selling Government securities and by increased borrowings from the Federal Reserve Banks. Holdings of Government securities have fallen by $ 5 billion and member bank indebtedness has shown a marked tendency to rise In the USA.

Enhanced Demand for Credit

During the busy season of 1950-1957 the enhanced demand for bank credit has aggravated the problem of bank finance still further. The credit-deposits ratio had already risen to 70.21 per cent in October 1956 as compared with 57.98 per cent in October 1955.It further rose to 71.12 per cent in December 1956 and to a peak of 73.27 per cent in January'1957. The resources of the banking system appear to be clearly inadequate to satisfy the rising demand for funds. A further raising of the advances deposit ratio would clearly be an unsound policy especially in the context of the current security pattern of the banks' advances. During the last two years 1954 and 1956 the liquid character of the advances has tended to deteriorate remarkably. While the percentage of advances secured by real estate rose from 4.6 per cent in 1953 to 21.3 per cent and 20.4 per cent in 1954 and 1955, the proportions of advances secured by Government securities fell from 8.5 per cent in 1953 to 0.7 per cent in 1954 and 0.6 per cent in 1955, and those secured by merchandise declined from 46.1 per cent in 1953 to 18.1 per cent in 1954 and 20.7 per cent in 1955.Neither the cash ratio nor the investment-deposits ratio can be reduced further. In the circumstances the main source of credit in the busy season would have to be the Reserve Bank.

Loans to the banking system against the pledge of Government securities will have to be on an Increasing scale. Open market purchase operations will be likely to aggrevate the inherent inflationary forces and may have to be restricted. The bill market scheme will have to be liberalized further. The scheme has already begun to impart greater flexibility to the money market. It has grown so popular that the Reserve Bank raised its lending rate under Sec. 17 (4) (c) of the Reserve Bank of India Act from 3 per cent to 3 1/2 per cent from March 1956 and withdrew the concession on the stamp duty.

Rural Savings: the Solution

The real solution of the problem, however, lies in the Increase in the resources of the banking system. A large amount of money tends to remain in the pipe line. With the development of rural areas and rising money incomes of the rural people large amounts of cash are likely to be absorbed which may not readily come back to the banking system. Banks have no suitable agency for mopping up the rural resources at present. An all out effort should be made to tap the savings of the rural people and to bring them back Into the fold of the organised banking system. A large amount of money, consisting inevitably of currency, is also lying in hoards in the shape of concealed income. Mr Kaldor has estimated the amount of Income tax lost through tax evasion to be of the order of Rs 200—300 crores.[18] That gives us an Idea of the extent of the fraudulent concealment of Income.

The possibilities may be explored of the device of "bearer bond Issuas for tapping this hidden money and bringing it back to the banking system. A well known banker had sometime ago suggested the adoption of a scheme of "bearer deposits" and "bearer certificates'' to meet the hoarding habit of the illiterate and ignorant people. Provided no questions were asked, the issue of "bearer bonds" is also likely to induce the return of the concealed income to the banking system. Through the more widespread extension of branch banking and through a greater degree of organization in marketing, warehousing and other trading activities throughout the country the deposit component of the money supply may also be increased to some extent.

Restrictive Monetary Policy

A reference may be made in this connection to the question of the adoption of a restrictive monetary policy by the Reserve Bank in view of the potential threat of credit Inflation. In recent months the Federal Reserve System, confronted with a rising trend of bank advances under the pressure of a continued heavy demand for funds has followed a policy of restraint and raised the discount rate 1|4 percentage point to 2.3|4 per cent at 10 Reserve Banks and 1/2 percentage point at the other two[19] Should the Reserve Bank adopt a policy of mild restraint and raise the Bank Rate? Or should the Reserve Bank take recourse to the device of the variable reserve ratio, with which it has been armed recently. The rate of interest on bills of exchange under the bill market scheme is theoretically 3 1/2. per cent. As the stamp duty has been increased, It works out In practice at 4 per cent. In the circumstances the Bank Rate has been virtually revised.

Selective Credit Control

The Reserve Bank has not announced a raising of the Bank Rate straightaway only to avoid its repurcussiong over the psychology of the people. In view of the far-reaching repurcussions that the variable reserve ratio is capable of producing, unless Its application is hedged round by various restrictions, it would not be advisable for the Reserve Bank, inexperienced as it is In the handling of the instrument, to resort to it at the present moment when the Second Plan is unfolding Itself and a high degree of stability In the money market and of confidence in the private business sector is called for. Reliance should be placed to an Increasing extent on selective control devices. Selective credit control has already been initiated by the Reserve Bank since May 1956 in respect of bank advances against certain commodities; but its range has to be widened. A vigilance will have to be exercised on the advances policy of the commercial banks and pressure or relaxation will have to be exerted at the strategic points, whenever necessary.

Expansion of Banking Functions

As the banking system would be called upon to play a more signlilcant role in the context of the Second Five Year Plan, the question of widening the range of banking functions may also be studied in this connection. A suitable line of extension of banking activities appears to be the development of the business of productive credit for agriculture. The major part in this sphere will no doubt be played by the State Bank and the Cooperative banks. But the part which the ordinary banks can still play in this field is not insignificant. The smaller regional banks are even now providing some assistance in this respect. With an increase In their deposit resources and greater access to central money market funds and under sound management they may usefully develop this line of business.

Another sector which has hitherto suffered from lack of bank finance in India is the small-scale industries. The emphasis placed in the Second Plan on such industries stresses the need for taking steps to improve the present position, of credit facilities with regard to them. In a country like the U S A which is the home of large businesses and large banks, small business concorns have received remarkable assistance from the banking system. According to a survey carried out in 1946 advances to small business accounted for 3/4 ths of the number and 1|5th of the amount of all business loans of member banks. ,In the case of the smaller banks 92 per cent of the number and 82 per cent of all outstanding business loans represented advances to small business.- Although there was a shift towards medium sized borrowers in 1955, loans to concerns with assets under $ 50,000 amounted to 46 per cent of the number as against 65 per cent in 1946 and to 6 per cent of the total amount of loans outstanding as against 9 per cent." Without making radical departures from existing banking traditions the banks in India can meet the pressing needy of small business through a little readjustment of their practices and collaboration with the various other agencies in the field of short term credit. On American lines they may develop' for instance, the practice of lending to small borrowers on the security of an assignment of accounts receivables. Their Value as collateral is a high fraction, of the face value and If the borrowers' trade customers fail to pay their accounts, the banks can always realize from the borrowing business concerns themselves.

Term Loans

The question of broadening the range of banking functions inevitably raises the point whether the banks should widen their horizon still further and provide longer term loans and even permanent capital to industry. In the present position when the banking system is fully loaned up, the question of extending further the further of its activities along such lines may appear to be of academic Interest, But in the future with the mobilisation of rural and other savings If the resources of the banking system can be increased, there is no reason why bankers in India should not think of widening their horizon and develop along new, though somewhat unorthodox, lines.

Long-term Lending to Industry

In the years after World War II when the commercial banks all over the world were enjoying unprecedented liquidity, opinion was growing in favour of their making a limited departure from "orthodoxy" and develop with profit and without risk long-term lending policies to industry. Mr Goldenweiser in, the U S A and Lord Wardington of the Lloyds Bank in the U K were the leading exponents of this view-point. In the U S A commercial banks had already developed the term-loans business in the 1930's. Such business has now come to constitute an important line of, their activity.

These term loans are made for more than one year and generally upto five years against the security of machinery and equipment, stocks and bonds and to a smaller extent against real estate. During 1946 term loans constituted 20 per cent of the number and 33 per cent of the dollar amount of all member bank loans outstanding to business concerns.[22] In October 1955 such loans accounted for 34 per cent of the dollar amount of member bank business loans which was about the same proportion as in 1946."[3] An interesting feature of recent banking legislations in underdeveloped countries is the explicit permission given to commercial banks to make term loans upto a period of three years and in some cases beyond three years with the sanction of the Superintendent of Banks. The Banking Laws of Guatemala, Paraguay and the Dominican Republic furnish instances of such provisions.

Liberalisation Needed

Pointed attention to the question of commercial banks making a limited departure from the conservative codes of banking practice has been drawn by Sir George Erakine, President of the London Institute of Bankers In a recent speech. He suggested that the banks might make advances to institutions and other. Investors to assist them in taking up new securities and be prepared to widen their Investment policy so ail to take up, in order to hold, new issues of debenture stocks and preference shares, and perhaps, of equities.

These are far-reaching suggestions and would Involve radical changes In the existing practices of commercial banks. The risks and costs and unfortunate experiences in the past of commercial banks venturing into the field of long-term investment do not prompt us to recommend the wholesale and widespread adoption of Sir George Erskine's suggestions by commercial bankers in India where sound banking traditions similar to those of Great Britain have not yet developed. At the same time in the context of the expanding economy of the country during the plan period when the banking system will be called upon to play a more significant part In the financing of the private sector, we consider that the banks will be justified In making a limited departure from strict "orthodoxy".

The finance required for planned development and expansion of private Industry is on so large a scale under modern conditions that it may be necessary for the bank ing system to place a portion of its resources at the disposal of private industry. In the circumstances when there Is a sizable Increase of their deposits, some of the commercial banks in India may well consider the desirability of a little readjustment of their existing practices and examine carefully the possibility of granting term loans, on the lines of American banks, with a maximum maturity of 5—1.0 years for financing the development and expansion of the industries to which the Plan has given priority.

Attention has already been drawn to the rising percentage of time deposits. A certain proportion of these time deposits which represent longer terms resources can be legitimately employed in longer term loans. The aggregate amount of these fixed loans, however, would have to be limited to a certain percentage of their advances. Attention would have to be paid to the ratio of capital and reserves to deposits as well as to depreciable assets, the proportion of time and savings deposits to total deposits, the volume of the illiquid as against readily marketable assets constituting the secondary reserves and the useful maintenance of a proper spacing of maturities.

Role of IFC

If the banks including the State Bank agree to amend their existing practice in favour of making limited amounts of term loans, as suggested above, the practical method would be for the banks as a whole to operate through a chosen instrument. I can think of no better institution to be the chosen instrument than the Industrial Finance Corporation of India. The Corporation is confronted with the problem of having to augment Its resources and may have to borrow from the market at relatively higher rates of interest in the near future. If the banking system decides to place a portion of its resources with the Corporation either in the form of long-term fixed deposits or in the from of subscriptions to its bonds, the Corporation should welcome the idea and employ the funds for making term loans to industry.

The banks may also jointly participate with the Corporation in making term loans or in taking up the debentures of the industrial customers or in underwriting the share issues. The Corporation is equipped with the necessary machinery for the scrutiny of the technical, financial and economic aspects of industrial propositions as well as for the appraisal of the assets offered us security which ordinary banks are not expected to possess. Thus the Corporation and the banking system may join hands and cooperate in financing the industrial development of the private sector during the Second Plan period.

Examples Abroad

A short study of the capital account of German enterprises (private and public) shows that in 1953 out of total resources of 23.1 billion DM bank credits amounted to 8.5 billion DM and in 1956 the amounts were respectively 23.8 billion DM and 9.4 billion DM. In Italy too expansion of bank credit has been quantitively more important than funds from the capital market. In 1954 out of a total external finance of 838.1 billion lire bank credits amounted to 470.6 billion lire, while new issues were only 153.3 billion lire. In France bank credits have continued to play an important part. The rising trend of bank advances to industry in these countries has coincided pari passu with the tendency of peraonal savings to be accumulated in the form of fixed savings deposits. Such deposits represent relatively longer term resources and have come to be regarded both by the banks and the authorities as funds which can be appropriately employed in longer term investments. In underdeveloped countries banks, as already noted, have been expressly permitted by the banking laws to furnish term loans upto three years, and even beyond that period, to agriculture and industry. In several Latin American countries commercial banks are also extending medium term and long term credit to industry either directly or through the official entities such as the Development Corporations. In Brazil and Chile they have combined commercial with investment banking functions. In Mexico under the banking law of 1949 steps were taken to secure increased participation by commercial banks in the financing of industries, but restrictions have been Imposed on the total of such loans and investments.

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