Weekly Notes

Development Rebate on Ships

THAT the Finance Minister is not happy with the present system of development rebate is well known. He wants a more selective system to encourage industries which are basic and important instead of extending the rebate to all industries. The rationale behind this is not difficult to accept, but some of the changes which have been made seem rather pointless and ill-considered. Take, for instance, the reduction of development rebate allowable on second-hand ships. Development rebate was first introduced on new ships acquired or rew machinery or plant installed after March 31, 1954, the rate of rebate being 25 per cent for ships. The concession was extended to second-hand ships in 1955. It was felt at the time that purchase of new vessels would be unnecessarily expensive, and that it would be desirable for the Indian fleet to be expanded with second-hand tonnage. In 1957 when the present Prime Minister was Minister for Transport and T T K was Finance Minister, the development rebate was increased from 25 per cent to 40 per cent. At the same time a Shipping Development Fund was set up to provide finance to the shipping companies. The Development Fund and the higher development rebate have been regarded by many as the twin pillars which have supported the rapid growth of Indian shipping in recent years.

The reduction of the development rebate from 40 per cent to 20 per cent on second-hand ships in the 1965-66 Budget, therefore, came as a complete surprise to the shipping industry. The full implications of the cut do not seem to have been adequately considered by the Government. It is possible perhaps that the Transport Ministry was not even consulted. Why the Finance Ministry chose to make a distinction between new and second-hand tonnage is incomprehensible. Is it the argument that on principle purchase of second-hand ships or plants should not be encouraged? Whatever its validity in relation to industrial plant, in shipping at least it remains a wise policy to buy second-hand tonnage during a slump and new tonnage in a boom. The reason is very simple; in a slump second-hand tonnage is discounted at a higher rate and in a boom new ships maintain a steadier price; to the extent, therefore, that the rebate differential between new and second-hand tonnage encourages shipowners to buy new tonnage, the reduction will be harmful, particularly when shipping is still in a mild slump.

Foreign Investment vs Loans

IT is now taken for granted that development needs external assistance. The classical form of such assistance was through foreign investment—in the extraction, transport and, subsequently, other sectors. The post-World War II phenomenon is, of course, government to government assistance and its variant of loans from international institutions. This is but a reflection as much of the changed politico-economic set up in the world which has made the private investor unwilling to rush his capital into the 'newly emerging, countries (if he was lucky enough to escape expropriation or a phased easing out) as of the fear in the minds of the resurgent countries of domination by private foreign interests—a fear not unfounded in view of the character of such investment in the past

We, in India, have passed through several phases in our attitudes towards private foreign investment—from one of suspicion at first to tolerance and now avid espousal. The external assistance we have sought has been largely on an official basis mostly from foreign governments and international institutions as loans (and, to some extent, grants) and was fitted into the programmes of development This was natural as the emphasis in the earlier phase of our planning was, rightly, on infra-structural investment —a field which, despite the 19th century experiences of foreign investment in railways, etc, is not calculated to enthuse the foreign investor. The changing emphasis on investment in manufacture has widened the scope for foreign enterprise. Of greater import is our exchange problem. Official loans with fixed amortisation periods mean higher immediate costs in debt servicing and our ability to service the growing external debt has been put under increasing strain, as the current exchange crisis bears out. The Third Plan estimated our debt financing needs at Rs 550 crores whereas the preliminary estimates of the Fourth Plan point to a figure nearly twice as large. Attention has, therefore, turned to the prospects of foreign private capital providing the external resources (and technical know-how) without the immediate strain on exchange reserves.

The Economic and Scientific Research Foundation, an organisation financed by the Federation of Indian Chambers of Commerce and Industry, has presented its case for foreign private capital based on the experience of the period 1956-60. It finds that during this period the annual outflow on account of direct private investment works out at 7 per cent of outstanding investment as against 11 per cent in respect of official loans and argues from this that greater reliance on the former would provide relief on external account. The authors of the study are, of course, aware that the outflows on account of foreign private capital and official loans are not strictly comparable. In the case of loans the figure includes both interest and capital amortisation; the loan is, therefore, a liability which would be liquidated in due course. In the case of private investment, the liability is a continuing one and, with plough back of profits, an increasing one.

Despite recognition of this vital difference, the study slurs over it by assuming that the increasing capital liability "is a purely notional one—so far as it is unlikely to materialise,,. This is assuming away the problem. In fact, on the basis of experience elsewhere and the experience in India of the volatile nature of oil companies' profit repatriation, we know that cutflows in respect of private capital can be de-stabilising—tending to aggravate a weak exchange position and strengthen a strong one! In any event, increase in external capital liability over a period is not a prospect one can view with equanimity from the payments angle, especially when we know the sheltered condition of the Indian market and the profitability ratios.

There is another point to be noted with regard to the findings of the Foundation's study. The years chosen are 1956-60 when most of the loan assistance was on hard commercial terms. Since then, there has been a great deal of softening of the terms of aid both in terms of lower interest rates and longer maturity dates. This would make a substantial difference to the comparisons effected.