CHAPTER VI
LIBERALIZATION OF FOREIGN INVESTMENT POLICIES AND PRACTICES

Introduction:

Study in the previous chapter highlighted the determinants of foreign investments in India. The facts are analysed to reveal the gains to investors in India and other countries of the region. It is observed that investments in India are substantially lucrative. The present chapter goes into the question of reforms of taxation policy, money and capital market from the point of view of foreign investors.
Taxation Reforms:

There is difference of opinion among academicians about efficacy of monetary and fiscal policies in dealing with foreign investments. A view exists that taxation policy in open economy cannot act as a governor of the economy; the state is neither a producer nor a consumer. What it takes in taxes is returned to the community in procurement of goods and services to satisfy social wants. However, it acts as a tool to divert resources from the private uses to public uses. State is sovereign to look after social welfare. In the Paleo days, it was
held that money in the pocket of the state is wasteful and in the private hands it fructifies. It got its support from limited functions that the State used to perform safeguarding the borders from external aggression and maintaining internal peace. With social and political awareness, functions of the State multiplied many times over. It has taken upon itself the role of social welfare promoter. Democratic state has to be responsive to the community. There is no activity that the state does not have to assume one way or the other. Private individuals, out of their free will and unfettered decisions, and on the basis of rationale objectives as consumer and
producer, perform production, consumption and distribution. State as producer has the strong motive to get busy with income earning activity; and as a consumer it makes a conscious or unconscious choice of goods and services which yield maximum satisfaction to the community. The state puts limit to resources that an individual can lay hands on for private benefits. Collective interests are the obligations of the State that it seeks to fulfil by laying claim to resources of private individuals in the community. Members of the community part with the resources and hand them over to the state in the payment of taxes. The fiat of the state to part with
resources in the interest of social welfare without quid pro quo is the essence of compulsory contribution by the community to social welfare funds. It is called a tax, a compulsory contribution to the national exchequer without quid pro quo for social welfare.

How far the state can go to tax community for social welfare while both the social and private ends are indispensable components of a healthy society? There is no easy answer to resolve the riddle of apparently contradictory private and social ends of resources that the State mobilises through taxes. However, the state is supposed
to allocate resources to private and public sectors on the basis of principle of maximum satisfaction from social and private consumption; the point of equality between the two determines maximum satisfaction. Market is the device to guide private allocations and, in democratic set up, it is the representatives from different constituencies who decide in the parliament house about social allocations of resources.

Of course, for a taxpayer it is always a cost that may injure the willingness to save and invest when additional taxes chop off additional income completely. It leaves little incentive to save and invest. In an open
economy, the state must use taxes for encouraging investments and promoting savings. It is possible when additional earnings net of taxes justify extra efforts by investors. It furnishes a concrete base to formulate tax structure with incentives for foreign investments.

The Tax Act, 1961, is the basic document that makes distinction between domestic and foreign investments. It distinguishes on the ground of ownership, management and control. It is foreign investment that is owned, controlled and managed outside the country. When ownership, control and management of
investment is inside the country, it is domestic. The Act makes application of the Finance Act for respective years to the base, rates and administration. Foreign investments attract following tax liability:

* Income Tax on dividend, interest, rental, royalty, profit, capital gains from Disinvestment after holding the assets for more than three years. In case of shares and securities, it is the period of one year for Disinvestment to determine tax liability on capital gains.

* Deductions are permissible beyond exemption limit of income for depreciation,
and provide incentives for industrial growth as follows:

Rent, taxes, rates, repairs, insurance of premise. Repairs and insurance of machinery, plant and furniture.
Liberal depreciation allowances.
Business loss can be carried forward for eight years. Unabsorbed depreciation can be carried forward up to eight assessment years. However, no carry back relief is available.
Foreign investors have to meet tax liability at a lower effective tax rate after allowing for permissible deductions.

Indirect taxes are regressive because of the multiplier effect like compound interest. Western countries have introduced Value Added Tax to cope with the multiplier effect of indirect tax. In the West, tax is collected from manufacturers according to the
value of specified product. In India, it is modified in the form of MODVAT. It has been introduced in respect of Excise duties on certain specified final products. Under the MODVAT credit can be taken of the Excise duty paid on the "inputs" or the countervailing duty paid on the import of the inputs into India. Countervailing duty is additional to custom duty on imports. It is a protective tariff duty.

In short, taxation policy has become quite liberal over the years since 1991. Following table makes comparative analysis of India with a few other Asian countries.
**TABLE 1: COUNTRY-WISE ANALYSIS OF TAXATION RATES 1997-98**

<table>
<thead>
<tr>
<th>Country</th>
<th>Corporate Taxation on Domestic</th>
<th>Foreign*Corporations</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>43%</td>
<td>23%</td>
</tr>
<tr>
<td>China</td>
<td>33%*</td>
<td>20%</td>
</tr>
<tr>
<td>Korea (South)</td>
<td>36.5%</td>
<td>22%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>35%</td>
<td>13%</td>
</tr>
<tr>
<td>Thailand</td>
<td>30%</td>
<td>18%</td>
</tr>
</tbody>
</table>

*Source: Compiled from different sources.*  

*It shows average taxation rates.*

The foregoing table makes it evident that India is heavily taxed country. There is still room to reduce corporate taxation rates further to be competitive with other countries. A foreign investor has to take the effective rates, which is net of incentives.

In successive Finance Act since 1991, package of incentives is provided for foreign
investors. Benefits of tax incentives are available when careful tax planning is carried out. Foreign investors in India are recognised to avail of low taxation rates on the basis of residence. Income of a non-resident entity is not taxable when it is received in foreign country and brought to India in foreign exchange. The income of a foreign company that is incorporated outside India is not taxable if the investor’s country has made Double Taxation Avoidance Agreement.

Double Taxation Avoidance Agreement is made with 55 countries. There are three methods of applying Double Taxation Avoidance Agreement ~ Exemption Method,
Credit Method and Tax Sparing Method. Under the Exemption method, income is wholly or partly exempted from taxation. Under the Tax Credit Method, there is a provision to allow tax credit for the taxes paid in the other country. Under the Tax Sparing Method, tax credit is available on certain specific incentives. In nutshell, Double Taxation Agreement covers the following areas:

* Relief in respect of income taxed in both countries.

* To avoid double taxation of income under the Income Tax Acts of both countries.
* To exchange information regarding evasion/avoidance of Income tax in either country.

- To recover income tax under the Acts of either country.

The following table summarises the taxation policy of the country.

Table 2: Statement Showing Changes in Sources of Tax Revenue

<table>
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<tr>
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<tbody>
<tr>
<td>(RE)</td>
<td>12</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(BE)</td>
<td>3</td>
<td>95</td>
<td>98</td>
<td>99</td>
</tr>
</tbody>
</table>

Tax Revenue as a percentage of Gross Tax Revue

- Direct: 19.1, 29.2, 35.9, 31
- Indirect: 78.9, 70.6, 63.9, 68.8

Tax Revenue as a percentage of Gross Domestic Product

- Direct: 1.9, 2.6, 2.3, 2.8
- Indirect: 7.8, 6.3, 5.8, 6.1

Source: Compiled from different sources
It is evident that indirect taxes are significant in the taxation structure though share of this source in Revenue is declining. Corporate income tax and the personal income tax are less important position though the yield from this source is increasing.

**CAPITAL MARKET REFORMS:**

Economic liberalisation policy initiated reforms in the capital market. The capital market has been under the supervision of Controller of Issue until the constitution of the Securities and Exchange Board of India in 1992. A mere 300 private firms were listed in the Stock markets all over the country. Stock markets in the country are either associations
of group of persons or joint stock companies. It is interesting to note that the Bombay Stock Exchange is an association. The stock exchanges of Delhi and Chennai are the registered companies under the Companies Act.

In the pre-liberalisation period, Controller of Issue had the powers to fix the prices of the issues. The companies did not have the freedom to make financial decisions. The quantum of issue, the full report about financial position used to be filed by the listed companies to the Controller of Issue. It led the companies more to rely on nationalised financial and banking institutions.
for the purpose of meeting their financial requirements. The Government also took to the financial and banking institutions to fulfil its own needs for additional funds.

The new economic policy put an end to the era of controls, rules and regulations in the capital market. A number of measures have been initiated to make the capital market open and transparent. It includes in the first instance incorporation of Securities & Exchange Board of India in 1992. The Securities Laws (Amendment) Act, 1995, has given powers to the SEBI to register and regulate market intermediaries including custodians, depositories, venture capital funds,
credit rating agencies and foreign institutional investors. The Depositories Act, 1996, has paved the way for establishment of the depository and scripless trading system. It would be worth taking stock of changes in the relevant laws, rules and regulations in order to make the capital market open and transparent.

The Securities Contracts (Regulations) Act, 1956, is the first legislation for regulating stock exchanges in the country. It was enacted for the regulation of stock exchanges and all transactions in securities dealt in on them. The legislation prevents undesirable
speculation. It ensures fair dealing to protect investors.

Control over Trading Methods and Practice:

The Securities Contracts (Regulation) Act empowers recognised stock exchanges to make rules, bye-laws and regulations to provide for matters relating to the stock exchanges and trading thereon, e.g., the rights, liabilities and obligations of the members of the stock exchange, the opening and closing of markets and the regulation of the hours of trade, the making and settlement of contracts, the regulation and maintenance of a clearing house, the listing of securities, brokerage, arbitration, and all
other matters connected with stock exchanges. The SCR Act empowers SEBI to make or amend bylaws of a recognised stock exchange. It gives powers to SEBI to call for periodical return and to direct the governing board of a stock exchange to make inquiries with regard to the functioning of the stock exchange.

The SCR Act prohibits contracts between non-members. The Act also prohibits persons from carrying on business or dealings in securities in any notified area or state unless they have been granted a license in that behalf by SEBI. Besides, recognised stock exchanges have been
permitted to establish additional trading floor with the prior approval of SEBI. The Securities (Amendment) Act, 1995, has allowed options trading in securities which was not permitted until then.

The Act is quite liberal for the listing of securities on recognised Stock Exchanges. There is no statutory obligation that a public limited company should get its shares listed on a recognised stock exchange. However, every company intending to offer shares or debentures to the public by the issue of prospectus must make an application to one or more recognised stock exchanges for permission to "list" its shares, failing which it
has to refund the application money to the applicants. The rules made under the provisions of the SCR Act provide for applications by public limited companies for listing of securities on a recognised stock exchange. The Stock exchange will admit the securities for listing provided the requirements prescribed by the SCR Rules and the Stock Exchange's rules, bylaws and regulations are complied with. The listing regulations of all the recognised stock exchanges are now uniform and a company desirous of having its shares admitted to official dealings has to observe the requirements stipulated therein. For the shares of a company to be listed on
a recognised stock exchange, the minimum
issued capital of the company should not be
less than RS. 3 crores of which a minimum
of 25 per cent should have been offered to
the public. It is no longer necessary to list
debts together with the equity. Debts can be
listed without listing of equity.

It is mandatory for the company to
register transfers except on the ground
provided under the SCR Act. The company
may refuse to register transfer if the
instrument of transfer is not proper or
prejudicial to the interest of the company or
against public interest.
**Buy-back of Shares:**

The Companies (Amendment, Ordinance promulgated on October 31, 1998) has empowered companies to purchase their own shares or other specified securities. It is subject to the regulations that the SEBI has framed in this behalf.

**Sweat Equity:**

The companies engaged in information technology (IT) Software and IT Services have the options to offer to its employees sweat equity shares. The sweat shares are given to them in recognition of their technical know how or specific
contribution to the value addition of the products.

*Take-over Regulations:*

The SEBI has amended Substantial Acquisitions of Shares and Take-overs Regulations, 1997, to raise the creeping limit from 2 per cent to 5 per cent for all persons holding between 15 per cent and 75 per cent of a company's shares. Acquisition beyond the 5 per cent limit shall mandate an open offer in terms of the regulations.

*Investments by NRIs and PIOs:*

Non-resident Indians and Persons of Indian origin have got free access to the Indian capital money markets without the prior
consent of the Reserve Bank of India. By notification of the Reserve Bank of India of March 30, 1999, the NRIs and PIOs can deposit money in rupee in any bank in India. They can buy and sell shares in the stock markets in India. They have the right to repatriate their capital and income like any foreigner who has investments in India. In other words, the NRIs and PIOs have the dual benefits of their origin, nationality and residence. Hopefully, the incentives would go a long way in attracting funds of NRIs and PIOs, which they are operating with from Mauritius.
Structural Reforms of the Capital Market:

A number of steps have been taken to introduce structural reforms and changes in the methods and practice of trading on the stock markets. A short description of a few significant changes is given in the following paragraphs:

Derivative Trading:

The National Stock Exchange (NSE) has initiated necessary steps to introduce Stock Index Futures Market to be adopted by the derivative exchange. It is regarded as the crucial step to regulate volatility in the stock markets.
Dematerialised Trading:

The SEBI has introduced dematerialised trading to avoid risks of bad delivery and fake or forged shares. The following table gives a synoptic view of the progress in Demat Trading. The table makes it evident that the Demat Trading is coming up as an important segment of the capital market.

Table 3
Statement Showing Progress in Demat Trading

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Number of Companies signing Agreement</td>
<td>12</td>
<td>40</td>
<td>191</td>
<td>301</td>
</tr>
<tr>
<td>(ii) Cos. With demat Facilities</td>
<td>4</td>
<td>23</td>
<td>171</td>
<td>291</td>
</tr>
<tr>
<td>B. No. of DPs.</td>
<td>10</td>
<td>24</td>
<td>49</td>
<td>76</td>
</tr>
</tbody>
</table>
Credit Rating:

The SEBI has made it mandatory for every company to get credit rating. The credit rating is the guidance to investors in the financial decision-making process.

Another significant development in the new issues market is the establishment of the Credit Rating & Information Services of India Limited (CRISIL), set up jointly by UTI, ICICI, LIC, GIC and the Asian Development Bank.
The Investment Information & Credit Rating Agency of India (ICRA) is set up by IFCI and Credit Analysis and Research Ltd. (CARE) is set up by IDBI.

The primary objective of these credit rating agencies is to rate debt obligations of Indian companies. The credit rating serves the purpose of an index to guide investors. It can be assessed as to whether borrowing company has the capacity to bear burden of timely payment of interest and principal. Duff and Phelps Credit Ratings India Private Ltd. has also been recently set for credit rating. The rating is done after taking into account various key factors including industry
risk, market position, operating efficiency of the company, track record of management, planning and control systems, accounting quality, financial flexibility, profitability and financial position of the company, apart from its liquidity management, asset quality and the quality of company’s credit risk management.

**The OTC Exchange of India:**

The OTC Exchange of India (OTCEI) is a public limited company incorporated under the provisions of the Companies Act, 1956, OTCEI is promoted by the Unit Trust of India, the Industrial Credit and Investment Corporation of India, the Industrial
Development Bank of India, the Industrial Finance Corporation of India and others. It is a recognised stock exchange under the SCR Act. The OTCEI has set up a national, automated, screen based and ringless stock market. OTCEI helps companies to raise finance from the capital market in a cost-effective manner. It provides a convenient and effective avenue of capital market investment for small investors.

OTCEI is the stock exchange for small companies. It does not impose the limit of Rs.3 crore of issued capital of the companies for listing their stocks on the stock market. It does not require the company
to offer 25 per cent of the issued capital to the public. It fulfils the need of the small companies for an easy access to the capital market. OTCEI is the second tier stock market to help small companies list their stocks. The minimum issued equity share capital of a company for eligibility for listing on the OTCEI is RS. 30 Lac.

OTCEI will benefit companies by enabling them to obtain a fair price of their securities. The companies are free to negotiate the same securities with the sponsors (who are members of the OTCEI). It spares them unnecessary issue expenses by placing their securities with the sponsors who
in turn offload the securities to the public. This mechanism is now popularly known as bought-out deal. OTCEI enables the companies to retain a greater degree of management stability. It lists Scripps even with 20 per cent of the capital for public trading.

OTCEI will benefit investors, as investment in stocks will become easier. OTC's wide computerised network will be spread all over India. It will connect stock exchange to the main frame computer of the OTCEI. The exchange will provide greater confidence as the investor can look up the price displayed at each OTCEI computer
counter. The exchange will enable transactions to be completed quickly and investors can settle the deals across the counter. The deals will be settled in a matter of days if not earlier. The exchange will also provide liquidity to investors, as every scrip listed on the OTCEI will have at least two market makers that will continuously give two-way quotes.

National Stock Market System:

National Stock Market System (NSMS) is a system designed basically to provide an opportunity to an investor in any part of the country where NSMS facilities are available to trade at the prevailing best market price in
any qualified security, through an eligible member of the NSMS Exchange.

**Mutual Funds:**

Unit Trust of India, (UTI) is the first mutual fund in India on the lines of English and American mutual funds in. It runs several collective investment schemes, the 1964 scheme being the open ended scheme and all other being close ended schemes. UTI is exempt from Income Tax. The monopoly of UTI continued till 1987 when the Government permitted subsidiaries of public sector banks to start mutual funds. The profits of these mutual funds are also exempt from Income Tax. It is now suggested that
any company with a good track record after obtaining registration with SEBI can promote a mutual fund. SEBI has issued detailed guidelines to ensure that the trustees, assets Management Company and custodian are separate entities.

The SEBI has lately made sweeping changes in the mutual fund industry. It has approved derivative trading, the NAV Committee reports, and norms for venture funds and money market mutual funds. These changes are geared towards providing greater flexibility to mutual funds. The reforms would revive the mutual fund
industry, which had been passing through a rough phase.

In a bid to eliminate the problem of discounts on listed MF schemes, SEBI has agreed to relax the mandatory requirements of immediate listing of scheme. All closed-ended schemes are offering daily continuous repurchase facility to investors. Open ended mutual fund schemes (including US-64) have also been allowed listing.

SEBI has also allowed issue of repurchased units, which will provide liquidity to investors and provide incentive to MFs to repurchase units from investors in large quantities. It has also approved the NAV
Committee report on standardisation of valuation norms, computation of NAV, accounting practices and fee structure. The investment restrictions on MFs have also been eased. Now MF schemes can invest upto 10 per cent of the capital of a single company, which was 5 per cent earlier. The restriction on single industry has been removed. MFs can now also invest in asset—backed securities, like money market instruments and gilt—edged securities. SEBI has also decided to raise the minimum net worth of Asset Management Companies (AMCs) to Rs.10 crore to provide for strict entry barriers. The AMCs have also been allowed to diversify their activities to
manage other funds like offshore funds, venture capital funds and pension funds.

*Offshore Funds:*

Until recently, capital markets were closed to foreign investors and the only entry available was through listed country funds. Investors in these funds have largely been international pension funds, life assurance companies and institutional investors. The first fund of this type, the India Fund, was launched by the UTI in London in 1986. This fund of Stg Sterling pound 75 million was succeeded by another, the India Growth Fund of 1987, launched in the USA, which mobilised US 4 60 million. The rights offer
of Stg Sterling Pound 41 million made by the India Fund in 1988 was fully taken up and placed out. Offshore funds are a successful inlet of foreign investments.

The Stock Market Instruments:

The Indian Stock markets have not yet been able to develop a comprehensive range of instruments to meet the diverse requirements of the investing public. Equities continue to be the main stay of the market. However, in recent years, convertible debentures, which are converted into equities, either fully or partly, have become popular. Since August 1991, the interest on debentures has been completely deregulated. Companies
have free hand in fixing the rate of interest. However, credit rating of all debt instruments is compulsory. It applies to public sector and the private sector companies both. It covers debentures that are fully convertible within 18 months at a pre-determined price.

Companies have floated some quite new instruments, e.g., warrants/special premium notes attached to non-convertible debentures, which give right to a subscriber to get equity shares at the end of a specified period. Zero-interest convertible bonds are offered at a discount to compensate for loss of interest. The price is low on conversion because they are interest free bonds. The
new instruments have been well received by institutional investors.

Securities:

Securities are defined by the SCR as debt bonds issued by the public sector enterprises. These instruments are popularly known as "PSU bonds". Some of the "PSU bonds" are exempt from income tax. The bonds of the Indian Railway Finance Corporation are such instance. The total value of PSU bonds issued till 1997 is estimated at Rs.5,21,000 million. A large number of banks and mutual funds trade in them.
Euro-Issues & Global Depository Receipts:

A large number of Indian companies are considering the issue of Euro-issues in order to financing their foreign exchange requirements. Initially a few blue chip companies ventured to enter the Euro-market, viz., Reliance, Tata Iron and Steel Company, Grasim Industries, and Essar Gujarat. Several international bankers and financial institutions have approached those companies to price and underwrite their issues.

Further is the addition of Global Depository Receipts which have been availed of to enter the Wall Street for meeting foreign exchange requirements in terms of US $.
Both the Euro-issues and GDRs have been an effective means of raising the capital in foreign exchange.

In conclusion, the capital market reform is the on-going process of economic liberalisation. These reforms form a strategy to attract foreign investors to India.

Reforms of Non-banking Finance Companies:

Reforms of non-banking finance companies have become necessary due to increase in the number of defaulting non-banking finance companies. The investments by non-banking finance companies in land have been limited to 10 per cent of the own
capital. The non-banking finance companies are under the obligation to make disclosures about their working results, assets and liabilities to the depositors. The step is necessary to check malpractice of the non-banking finance companies. The unincorporated bodies are not allowed to accept deposits from the public except from their relatives.

The restrictions on the non-banking finance companies are of far-reaching consequences in regulating activities in the finance sector.
All India Financial Institutions:

All India Financial Institutions (AIFIs) comprise the Development Financial Institutions (DFIs) and Investment institutions. The Companies (Amendment) Ordinance promulgated on October 31, 1998, has designated the Infrastructure Development Finance Company (IDFC) as a Public Financial Institution (PFI). There is a thinking that the different Development Financial Institutions should be amalgamated to form one Public Financial Institution. The objective is to harmonise working of the Development Financial Institutions.
The following table furnishes facts about the progress of All India Financial Institutions. The table shows achievements of the All-India Finance Corporations and the Development Finance Corporations. It is a healthy change in the structure of capital market to meet demand for long term funds for investment.

Table 4 — Statement Showing Assistance By AlFIs (Rs. In crore)

<table>
<thead>
<tr>
<th>Institutions</th>
<th>1997</th>
<th>1998-99</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Sanctions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>AlFIs</td>
<td>79939</td>
<td>49373</td>
</tr>
<tr>
<td></td>
<td>*52.8</td>
<td>46.9*</td>
</tr>
<tr>
<td></td>
<td>67667</td>
<td>36.9*</td>
</tr>
<tr>
<td>DFIs</td>
<td>70,617</td>
<td>44,563</td>
</tr>
<tr>
<td></td>
<td>58.4*</td>
<td>57.2*</td>
</tr>
<tr>
<td></td>
<td>61917</td>
<td>38.9*</td>
</tr>
<tr>
<td>Investment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Institutions</td>
<td>9322</td>
<td>4989</td>
</tr>
<tr>
<td></td>
<td>5913</td>
<td></td>
</tr>
<tr>
<td>B Disbursements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>AlFIs</td>
<td>51855</td>
<td>32073</td>
</tr>
<tr>
<td></td>
<td>36097</td>
<td></td>
</tr>
</tbody>
</table>
Money market activities have been in existence in India for centuries. Moneylenders who extensively financed trade and commerce carried out traditional banking activities. Their principal activities included the issue and discounting of Hundis and money lending.

Modern banking originated with the arrival of the British in India. The need for modern banking was felt in the early nineteenth century with the establishment of trading firms that opened banks in addition
to trading. Indian businessmen established banks during the latter half of the nineteenth century. These banks comprised joint stock companies.

The comprehensive Banking Regulation Act, 1949, provides the framework for banking in the country. The Act has been amended from time to time to enable the banks to address themselves to new tasks for economic development of the country. Reserve Bank of India is the Monetary Authority to keep banking system healthy and vibrant.

The Act has been amended by the Parliament to introduce the concept of social

The banking sector is now on the threshold of a significant restructuring process. With the growth in volume and the need for greater sophistication in the financial sector, major policy reforms are being initiated. These reforms are aimed at removing controls, which have become
redundant and aim at making the regulatory system stronger in areas, which would support orderly growth, greater accountability and financial stability of the banking industry. The emphasis is on proper disclosure in financial statements, improving capital adequacy and making them competitive.

The Narsimham Committee has made far-reaching recommendations to improve the financial and banking sector. These recommendations have been accepted by the Government in principle and are now in the process of being implemented. Some of the key recommendations are:
1. Permission to banks to raise capital through public issue.

2. Reduction in Statutory Liquidity Ratio and restrictions on its uses. Removal of Government involvement in operations of banks and the RBI to be the only regulating body.

3. Streamlining of the interest rate structure, removal of cross-subsidisation arising out of high interest rates for industry and low rates for farm and food sectors.

4. Abolition of branch licensing and policies on nationalisation of banks.
5. Permission to foreign banks to open branches provided they meet minimum capital requirements.

6. Permission to allow the formation of private banks in collaboration with foreign banks or as subsidiaries of foreign banks.

*The Banking Industry:*

The banking industry is divided into two broad categories, commercial banks and financial institutions. Commercial banks primarily meet the working capital requirements of industry and mobilise public deposits. Financial institutions are largely
Government-owned institutions, which provide long-term finance to business.

Commercial Banks:

Commercial banks comprise both the private and the nationalised banks in the public sector. Nationalisation of banks in 1969 resulted in the ownership of all major banks by the Government. As a result, commercial banking in India experienced a radical change. Social banking gained paramount importance, often at the expense of commercial prudence. Banks became the institutions to provide subsidised loans to economically underdeveloped sector such as agriculture. This was largely achieved by the
Government making it mandatory for banks to loan a fixed percentage of their total lending to the priority sector. Banks were also entrusted with the responsibility for encouraging small savings by expanding their branch network.

After nationalisation, banks recorded impressive growth in terms of branch expansion and mobilisation of deposits. Accessibility to banking services in small towns and rural areas led to quantum jump in deposits of the banks. However, compulsory branch expansion and social lending produced negative results. The quality of services and range of services deteriorated.
Number of commercially non-viable branches increased. The banks accumulated non-performing assets. As a consequence, banks showed low profitability. Huge bad debts have been written off. It made nationalised banks financially worse off. On the other hand, private banks recorded substantial profits.

Co-operative banks are an important part of the banking system in the country. Co-operative banks have been operating in the country since long with the objective of providing credit to weaker sections of the society, including small farmers, landless workers, artisans and others. There is co-
ordination between co-operative banks and commercial banks at all levels of operation. The Government has encouraged growth of co-operative banking in the country. The co-operative banks have been an effective instrument in mobilising household savings.

Besides the nationalised commercial banks, a number of foreign banks are operating in the country. The foreign banks are concentrated in the metropolis of Delhi, Bombay, Chennai and Calcutta. The prominent foreign banks in the country are Citibank, Hongkong Bank, Standard Chartered Bank, Deutsche Bank and Bank of America.
Foreign banks have been successful to grow at a faster rate than the nationalised banks. Sophisticated banking services of the foreign banks are comparable to any other bank in foreign countries.

*Emerging Dimensions of Indian Money Market:*

Important steps have been initiated to reform money market for investors in the country. The reforms are expected to have ameliorating effects on foreign investments. The reforms aim at improving liquidity, reducing cost of money and regulating the supply in tune with changing demand for money from season to season. Following
changes would have far reaching effects on foreign investments:

Introduction of 182-day Treasury bills, inter-bank participation, certificate deposit and commercial papers. Permission to NRIs and PIOs to open bank account in rupee is an important policy decision to increase foreign investments in the country.

Setting up of Discount and Finance House as a specialised institution with the purpose of developing bill market in the country.

To bridge the gap between the official and the market rates of interest. The banks are free to fix their rates according to the demand for and supply of money.
Relaxation in the bill rediscount segment of the money market.

Introduction of derivatives in bill market is an effective measure to encourage foreign investments.

Abolition of stamp duty in case of rediscounting of bills is the step in the direction for boosting foreign investments.

Permission to mutual funds and subsidiaries to operate in the money market is an incentive to undertake foreign investment in the country.

Banks and subsidiaries are now free to establish money market mutual funds in the country. Maturity and yield are now the main
factors that foreign investors can consider for investments in the country.

Variations in Fund Flows
Of Commercial Banks:
The commercial banks manage market liquidity according to variations in the demand.

Table 5—Variations in Fund Flow of Scheduled Commercial Banks (RS crore)

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Busy Seasons</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in Aggregate Deposits</td>
<td>18950</td>
<td>36,113</td>
<td>48,059</td>
<td>62,310</td>
</tr>
<tr>
<td>Increase in borrowings from RBI</td>
<td>2952</td>
<td>-1393</td>
<td>-1407</td>
<td>-268</td>
</tr>
<tr>
<td>Increase in other borrowings</td>
<td>-3</td>
<td>599</td>
<td>111</td>
<td>-237</td>
</tr>
<tr>
<td>Increase in other Demand and Time Liabilities</td>
<td>2637</td>
<td>5644</td>
<td>6085</td>
<td>9303</td>
</tr>
</tbody>
</table>

Source:

Increase In

RBI

Banks crore)
The table substantiates the view that
- the banks are responding to the demand
for liquidity in the market. It shows
resilience of the banking system that has
become mature enough to compete in the
global scenario of free economy.

To sum up, reforms are made in taxation
policy, structure of the money and capital market,
rules and regulations to promote foreign
investment in the country. Since 1991, incentive packages are incorporated in the successive Finance Acts. SEBI has been established in 1992 as an autonomous statutory body with powers to regulate intermediaries, depositories and others. The development of credit rating agencies, OTCEI, National Stock Market System and other components will go a long way in creating environment conducive to foreign investments in India.
REFERENCES

