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HIGHER INTEREST RATES AND INDUSTRIAL GROWTH

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THE ANNUAL REPORT of the Reserve Bank of India indicates that the over-all growth of industrial production in 1974 may be "in the region of 3 per cent, as compared to a growth of 1 per cent in 1973." As regards the outlook for 1975-76, the report sees "signs of revival of the otherwise depressed capital market." Unfortunately, the signs of revival of an acknowledgedly depressed capital market are not apparent to the naked eye. The dear-money policy initiated by the Reserve Bank in 1973 and intensified during 1974 has depressed the share market. The possibility of raising new or additional capital from the prospective or present shareholders is even less than dim. Reputed companies with solid assets have shown preference to borrowing at usurious rates of interest rather than risking issue of additional capital or even debentures. It is in this context that the effect of the recent increase in the interest rates by term-lending institutions like the I.D.B.I., I.F.C., State Finance Corporations, etc., has to be assessed. Accustomed to package deals in recent months, the industrialists were waiting with eager expectation for some relaxation of credit curbs and easing of interest rates to enable them to fight stagnation in demand and to stimulate fresh investment and diversification. Instead of relief, all that the industrialists got was a further rise in the interest rates by the term-lending institutions!

The Reserve Bank believes that the deceleration of inflation in 1974-75 and thereafter is due to the cumulative impact of strict monetary and fiscal policies. Fiscal measures like additional resource mobilization by the Centre (Rs 690 crores) and States (Rs 358 crores), together with measures like compulsory deposits, impounding of a part of the income and limitation of dividend have had a positive effect on money supply. The Bank claims that interest rates have emerged as an important instrument of monetary management and that interest rates which had been levered up to a considerable extent in 1974-75 had the twin effect of imparting discipline in the use of credit and aiding deposit mobilization.

Justifying the high interest rates, the Annual Report of the Reserve Bank states: "One of the prominent aspects of inflationary psychology is the attraction that the expectation of price increase gives to the accumulation of inventories. It is of vital importance in a scarcity economy that, apart from physical controls on distribution, the cost of holding goods should be maintained at a sufficiently high level so as to discourage this tendency. At the same time, it is of equal importance that the return on bank deposits should not be allowed to drop to such unattractive levels, in real terms, as to affect the pace of deposit growth."

It is observed that the time-deposit with banks increased by

Rs 1,107 crores in 1975 over that in the previous year. While the immediate and direct impact of higher deposit rates for attracting more savings cannot be questioned, the over-all consequence of an upward revision of deposit rates and lending rates on the growth and expansion of industries has to be carefully analysed. The Fifth Five-Year Plan, dealing with the policy towards private investment and savings had stated as follows: "A policy of offering higher interest rates on financial assets needs to be carefully considered for channellizing savings into the hands of public financial intermediaries. The effect of such a policy on the aggregate volume of savings being much weaker and less certain, *sharp increases in interest rates are neither desirable nor feasible*," (emphasis supplied). The increase in the interest rates effected in July 1974 and again during last month, coupled with a seven per cent tax on interest income from bank loans (which itself has pushed up the cost of credit by one per cent), have weakened the capacity of stock exchanges to channellize savings for industrial expansion and diversification. It is well-known that several large companies have, during the last two years, deferred their planned projects not only due to the tremendous increase in the costs of raw materials, machinery and equipment, but also because of the forbidding levels of interest rates. A perusal of the latest balance-

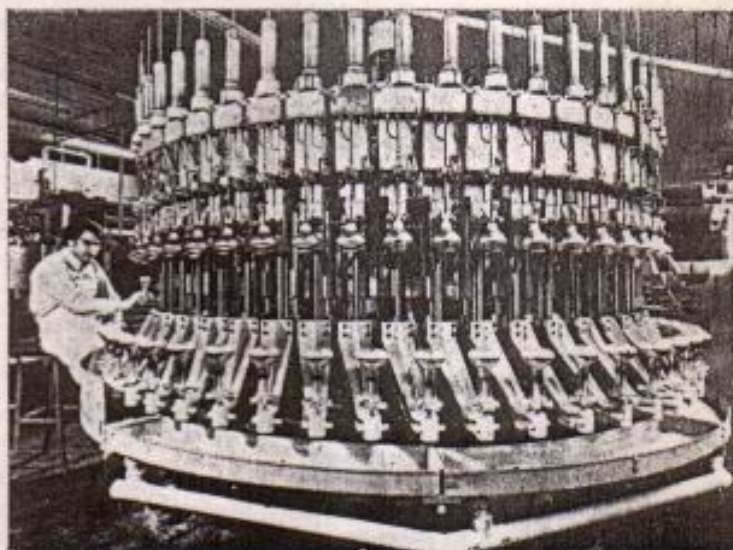
sheets of large and medium industries reveals the large increase in their expenditure on interest payments. To cite a few instances, interest, as an item of expenditure, increased from Rs 73.6 lakhs in 1973-74 to Rs 108.1 lakhs in 1974-75 in the case of Tata Chemicals, from Rs 167 lakhs to Rs 213 lakhs in Premier Automobiles, Rs 63.6 lakhs to Rs 127.81 lakhs in the case of Brooke Bond, from Rs 23.9 lakhs to Rs 40.4 lakhs in the case of Aruna Sugars, Rs 69.7 lakhs to Rs 109.6 lakhs in the case of Colour Chemicals and from Rs 46.4 lakhs to Rs 79.87 lakhs in the case of Tube Investments of India. The larger accretion to bank deposits through higher interest rates is offset by the loss to investment resulting from the deterring influence on the capital market.

The Reserve Bank's thesis that inventories are accumulated on the expectation of higher prices is at best a half-truth. Other factors, such as the rising cost of raw materials and stores, uncertainty in supplies, recourse to black-markets for procuring scarce raw materials and frequent power cuts, are some of the other factors contributing to the accumulation of inventories. Today, the situation is quite different. The major industries are faced with the problem of accumulation of stocks. Cotton textiles, jute goods, fertilizer, coal, steel, automobile and auto parts, tyres, machine tools, paper, tobacco and other industries, to name a few, are faced with an acute problem of marketing their stocks. The cost of carrying large inventories is weighing heavily on these indus-

tries. At a time when the profitability of most of the industries is shrinking fast due to substantial escalation of costs, the high bank charges on their inventories operate as a crushing burden.

The case for high rates of interest is also justified on the ground that in an economy like ours which is short of capital, wasteful uses of capital should be prevented and investment in low priority and low productivity schemes should be discouraged. While one has no quarrel with the above principle, one wonders whether credit squeeze and high cost of credit are the appropriate methods for achieving this objective. The desired goal of diverting investments from low-priority and low-productivity schemes is reached through industrial licensing, control of capital issues, determination of priorities to be followed by term-lending institutions and the like.

The use of interest rate as an instrument for channelling investment in priority sectors is not only inopportune but also has the deleterious effect of increasing the cost of production. High interest rates have already affected many consumer industries and the middle and low income group housing schemes. The small-scale industries, comprising over two lakh units in the country, have been finding the high rate of interest a severe deterrent to their growth. Government spokesmen indulge in appeals to the industry to lower prices, dispose of accumulated stocks, reduce inventories and step up employment. Only if demand is stimulated and the industry is put on the wheels again, will these appeals have any effect. The stagnation in demand is bringing industrial progress to a grinding halt and unless prices are reduced and brought within the reach of the consumer, the conditions will not change. The heavy excise duties and the high cost of credit are some of the major contributory factors to high prices. It is, therefore, necessary that the Government should examine these two factors and afford relief to the producer and the consumer.



Completely new and automatic equipment for depositing internal aluminium and other metal coatings on the glass bulbs of reflector lamps has recently been introduced by a British company. The process—one of the most advanced of its type in the world—consists of three machines which carry out the washing, aluminising and aluminium dissolving processes. The washing unit heated water jets to remove all traces of grease, fibre particles and salt deposits from the glass bulbs, while the second machine deposits a uniform coating of aluminium to cover the inside surface of the bulbs. The third machine (shown here) removes the reflective coating from the crown of the bulb to produce the window through which the light beam will shine. An accurately measured amount of dissolving solution is automatically fed into each bulb and is subsequently pumped out when the required window has been cleared.