

Madan as chairman extended the benefits of bonus to employees earning less than Rs. 2,000 per month and recommended minimum and maximum bonus of 8.33 per cent and 20 per cent respectively. Acting upon the Committee's recommendations, the government raised the minimum bonus from 4 per cent to 8.33 per cent. However, during emergency, the government scaled down minimum bonus to 4 per cent. The lifting of the emergency in 1977 brought the suppressed resentment of the workers into the open and there were large-scale strikes on the issues of bonus. As a result, the government had to raise the minimum bonus to 8.33 per cent. The eligibility for payment of bonus which stood at Rs. 2,500 earlier was raised to Rs. 3,500 by an amendment to the Payment of Bonus Act in August 1995. The payment is subject to the stipulation that the bonus in respect of employees drawing wages or salary between Rs. 2,500 and Rs. 3,500 per month would be calculated as if their salary or wage is Rs. 2,500.

### ■■■■ INDUSTRIAL RELATIONS : POLICY OF THE GOVERNMENT ■■■■

*India's industrial relations policy has had the following two basic objectives: (i) prevention and peaceful settlement of disputes, and (ii) promotion of good industrial relations via labour-management cooperation.* Let us consider below some of the statutory and voluntary arrangements devised for the prevention and settlement of industrial disputes in India. We have already discussed the government policy on the issue of bonus. Below we discuss the various other measures adopted by the government from time to time.

#### The Legal Arrangement: Industrial Disputes Act 1947

A major step towards accomplishing the first objective was taken in 1947 itself with the passing of the Industrial Disputes Act, 1947. The object was to pre-empt industrial tensions, provide a mechanism for the settlement of disputes and set up the necessary infrastructure. *The Act provides for the settlement of industrial disputes through conciliation, arbitration or adjudication.* It lays down the preconditions for the legality of strikes and lock-outs. Provision is also made for payment of compensation for lay-off and retrenchment. The Act has been amended several times (most substantive amendments being in 1982).

**Conciliation and Adjudication.** The Act empowers the government to appoint conciliation officers for bringing about settlement of disputes through conciliation. If attempts at conciliation fail, the government can refer the disputes for adjudication if the parties to the dispute jointly or separately apply for it or if the dispute relates to some public utility service and there is a notice of strike or lock-out. 'Disputes' which have not occurred but are apprehended, can also be referred for adjudication. For purposes of adjudication, there is a three-tier system consisting of Labour Courts, Industrial Tribunals, and National Tribunals. The Labour Court deals with disputes on minor matters such as the propriety or legality of an employer's order regarding discharge or dismissal of workmen, etc. The Industrial Tribunal adjudicates on more important matters such as wages and allowances, hours of work, leave and holidays, etc. National Tribunals tackle questions of national importance and those that affect establishments situated in more than one State. The parties can, by agreement, refer a dispute for arbitration before it has been referred to a Labour Court or an Industrial Tribunal or a National Tribunal for adjudication.

Ten Industrial Tribunals-cum-Labour Courts have been set up to adjudicate in the central sphere. Of these, three are at Dhanbad, two at Mumbai and one each at Kolkata, Jabalpur, Delhi, Chandigarh and Kanpur. The States have their own tribunals and labour courts. The Tribunal-cum-Labour Court at Kolkata and one of the Industrial Tribunal-cum-Labour Courts at Mumbai are functioning as National Tribunals.

**Lay off, Retrenchment and Closure.** The special provisions relating to lay off, retrenchment and closure are applicable to establishments employing 100 or more workmen on an average per working day. The Act also provides for protection in the shape of retrenchment compensation and notice to the workmen who have completed 240 days continuous service in the establishment in the preceding 12 months before effecting retrenchment, closure, etc.

**Work Committees.** The Industrial Disputes Act, 1947, provided for the setting up of a Work Committee consisting of representatives of management and employees in every undertaking employing 100 or more employees. The duty of the Work Committees was defined as promoting measures for securing and preserving amity and good relations between the management and the employees.

**Settlement of Grievance.** The amendment in 1982 introduced a new chapter providing for the setting up of Grievance Settlement Authority (GSA). The GSA is concerned with the settlement of all individual disputes in an establishment coming within its purview. An important feature of this machinery is that no reference to

a Tribunal/Labour Court is to be made by the appropriate government till such time the dispute is heard by this authority and its decision becomes unacceptable to any of the parties to the dispute.

**Unfair Labour Practice.** Another chapter introduced by the amendment in 1982 related to unfair labour practices on the part of the employer and workman as well as penalty thereof. The chapter says that no employer or workman or a trade union whether registered under the Trade Union Act, 1926 or not is to commit any unfair practice. Any person who commits such a practice is punishable with imprisonment or with fine or both. The amendment empowered the Registrar to verify the membership of any union and to cancel the registration of any union which 'calls' or 'participates in' an illegal strike.

### **The Voluntary Arrangement: Code of Discipline and Industrial Truce Resolution**

**Code of Discipline.** A Code of Discipline was adopted in 1958 by all the central organizations of employers and workers aimed at preventing and settling industrial disputes on a voluntary basis. The Code lays down that there should be no strike without notice; no unilateral action should be taken in connection with any industrial matter; no deliberate damage should be done to plant or machinery; acts of violence, intimidation, coercion or instigation should not be resorted to; there should be no recourse to go-slow tactics and normal work should not be disturbed; in case of disputes, the existing machinery should be utilised with the utmost expedition; the employers should recognize the majority union in the establishment and frame a grievance procedure; the management should take prompt action for the settlement of grievances and should implement the awards and agreements speedily, etc.

**Industrial Truce Resolution, 1962.** The Code of Discipline was strengthened by an Industrial Truce Resolution adopted in November 1962 by the central organisations of employers and workers. It laid down that there would be no interruption or slowing down of production; on the other hand, production will be maximized and defence effort promoted in all possible ways. A standing committee was set in August 1963 to review the working of the Truce Resolution. This has since been merged with the Central Implementation Evaluation Committee.

### **Other Measures**

**Regulation of Wages.** The payment of wages is governed by the Payment of Wages Act, 1936, and Minimum Wages Act, 1948, as amended from time to time. The Payment of Wages Act, 1936 has been enacted with a view to ensure that wages payable to employed persons covered by the Act are disbursed by the employers within the prescribed time limit and that no deductions other than those authorised by law were made. The Act covered only those workers whose wages were below Rs. 1,600 per month. However, *with effect from November 9, 2005, the Payment of Wages (Amendment) Act, 2005 has been put into effect which has raised the ceiling from Rs. 1,600 per month to Rs. 6,500 per month.*

The Minimum Wages Act, 1948 provides for fixation, review, revision, and enforcement of minimum wages by the Central government and the State governments in respect of scheduled employments in their respective jurisdiction. There are 45 scheduled employments in the Central sphere whereas the number of these employments in the States' sphere is 1,424. To protect the wages against inflation, the government introduced Variable Dearness Allowance (VDA), which is linked to Consumer Price Index. The VDA is revised every six months. So far, 26 States/Union Territories have already adopted VDA as a part of minimum wage.

In the absence of a uniform national minimum wage, the concept of a national floor-level wage was mooted by the Central government in 1996 based on the recommendations of the National Commission on Rural Labour in 1991 and subsequent increase in the price level. It was last revised to Rs. 66 per day from February 1, 2004.

**Industrial Employment Standing Orders.** Model rules were framed by the government under the Industrial Employment (Standing Orders) Act, 1948, for adoption by the industrial establishments employing 1,000 or more workers to ensure industrial peace. Amendments to the Act were made in 1961 and 1963. The Central Government by notification on May 19, 1982, extended the Act to all industrial establishments under the control of the government for which it is the appropriate government and all mines, wherein 50 or more but less than 100 workers are employed.

**Equal Remuneration for Equal Work.** The Equal Remuneration Act, 1976, provides for payment of equal remuneration to men and women workers for "the same work or a work of similar nature" and for the prevention of discrimination against women in matters of employment. The provisions of the Act have been extended to all employments.

## ■■■■ LABOUR LEGISLATION ■■■■

Labour legislation is considered as “a most dynamic institution. From a simple restraint on child labour in 1881, labour legislation in India has become an important agency of the State for regulation of working and living conditions of workers as indicated by the rising number and variety of Labour Acts. The rapid development of labour legislation is an integral part of modern social organisation.”<sup>4</sup>

V.V. Giri has classified labour legislation in India under the following broad heads:

1. Laws relating to weaker sections: (i) Children, and (ii) Women.
2. Laws relating to specific industries: (i) Factories and workshops, (ii) Mines and minerals, (iii) Plantations, (iv) Transport, (v) Shops and commercial establishments, (vi) Contract labour, (vii) Construction works, and (viii) Working journalists.
3. Laws relating to specific matters: (i) Wages, (ii) Bonus, (iii) Social security; (iv) Labour welfare, and (v) Forced or bonded labour.
4. Laws relating to: (i) Trade unions, and (ii) Industrial relations.<sup>5</sup>

### Laws Relating to Weaker Sections

The important legislations covering employment of children relate to minimum age of employment, health certification, working hours, employment on hazardous machines etc. The Factories Act, 1948; The Mines Act, 1952; the Plantation Labour Act, 1951; the Employment of Children Act, 1938; and the Shops and Establishment Acts of various States have determined the minimum age of employment. To ensure that children employed in factories are physically fit, the Factories Act provides that children upto the age of 18 cannot be employed unless they produce a Health Certificate which is considered to be valid for one year only. The Factories Act, the Mines Act, the Plantation Labour Act, and the Shops and Establishment Acts of various States have also prescribed the maximum hours of work for children. The significance of this legislative provision is that it prevents employers from employing children for long hours which is harmful at their tender age.

The legislative provisions for protecting the interests of women workers have been made primarily in the framework of the ILO conventions on (1) Maternity Protection, 1919; (2) Night Work, 1919; (3) Underground Work, 1935; (4) Equal Remuneration, 1951; and (5) Discrimination (Employment and Occupation), 1958. The government, however, also took into consideration the Indian situation while enacting various laws which either intend to safeguard interests of women workers or promote their welfare. From the point of view of women workers, maternity benefits are of great importance. In India, these benefits are provided under the Maternity Benefit Act, 1961, and the Employees State Insurance Act, 1948. The other legislative provisions for women relate to provision for creches, separate rest rooms and toilets and restrictions on lifting of weights and employing them in hazardous occupations.

### Laws Relating to Specific Industries

The Factories Act, 1948 which provides for licensing, registration and inspection of factories also protects the interests of workers. It ensures better conditions of work, regulates conditions of employment and provides for certain labour welfare measures. The Industrial Employment (Standing) Orders Act, 1946 defines the rights and obligations of both employers and workers in respect of recruitment, discharge, holidays, leave, disciplinary action etc. The purpose of these legislative provisions is to minimise the scope for disputes between management and workers in industrial undertaking. The Factories Act also provides for the framing of standing orders in all industrial establishments, including factories, mines, plantations, railways and docks employing 100 or more workers.

The Indian Mines (Amendment) Act, 1959; the Coal Mines (Conservation and Safety) Act, 1952; the Iron Ore Mines Labour Welfare Cess Act, 1961; the Coal Mines Labour Fund Act, 1947; and the Coal Mines Provident Fund and Bonus Schemes Act, 1948 are important labour legislations in the field of mining activity. The Indian Mines Act restricts the employment of workers in a mine when its owner does not comply with the notice of the Mines Inspectorate to rectify some such defect in the mine which may be hazardous to human life. The Coal Mines (Conservation and Safety) Act authorises the Central Government to take such measures which it may consider necessary for the safety of workers in coal mines. Other Acts in the field of mines relate to certain social security benefits to labour.

The Plantation Labour Act, 1951 applies to tea, coffee, rubber and cinchona plantations. The State Governments may, however, apply it to other plantations also. The Act regulates the conditions of work of plantation workers and provides for certain welfare measures beneficial to them.

The State governments have enacted legislations on shops and other commercial establishments. These Acts cover workers employed in shops, commercial establishments, restaurants, cinema theatres etc. They generally contain provisions in respect of hours of work, rest intervals, weekly holidays and overtime rates.

There are separate laws for regulating the working and service conditions of workers employed in different transport systems. The important legislations in this field are the Indian Railways Act, 1930; the Motor Vehicles Act, 1939; the Motor Transport Workers Act, 1961; the Indian Merchant Shipping Act, 1923; the Indian Dock Labourers Act, 1934; and the Dock Workers (Regulation and Employment) Act, 1948.

Construction work is an unorganised activity. There is no specific legislation to regulate the working and service conditions of construction labour. However, certain provisions of the Minimum Wages Act, 1948; the Workmen's Compensation Act, 1923; the Contract Labour (Regulation and Abolition) Act, 1970 and Standing Instructions relating to casual labour are applicable to construction labour. The limitation of these legislative measures is that they do not provide for the safety at work.

Contract labour is generally employed for casual or irregular work. The Contract (Labour Regulation and Abolition) Act, 1970 which is implemented both by the Centre and the States has abolished contract labour system in perennial economic operations. However, for casual and irregular economic operations, the Act seeks to regulate contract labour system as it is not possible to abolish the system. The Act applies to all contractors who employ 20 or more workers and the industrial establishments in which 20 or more workers are employed.

The Working Journalists and other Newspaper Employees (Conditions of Service) and Miscellaneous Provisions Act 1955 regulates the service conditions of working journalists and other workers employed in newspaper establishments. In this Act it has also been provided that the provisions of the Industrial Disputes Act with certain modifications are applicable to working journalists.

### **Laws Relating to Specific Matters**

Specific matters which are important from workers' point of view are wages, bonus, social security, welfare and abolition of forced labour. There are two important legislations in respect of wages. These are Payment of Wages Act, 1936, and the Minimum Wages Act, 1948. The Payment of Wages Act, 1936 has provisions whereby it is ensured that industrial workers are paid their wages at regular intervals and employers do not make any unauthorised deductions from their wages. The Minimum Wages Act, 1948 has empowered the appropriate governments to fix the minimum wage rate payable to workers employed in scheduled industrial operations.

The Payment of Bonus Act, 1965 regards bonus as a deferred wage and thus imposes a statutory liability on employers to pay it to their employees. The Payment of Bonus Act applies to every factory covered under the Factories Act and every other establishment in which 20 or more workers are employed on any day during a year.

The important social security legislations in India are the Workmen's Compensation, Act, 1923; the Maternity Benefit Act, 1961; the Employees' State Insurance Act, 1948; the Employees' Provident Fund Act, 1952 and the Payment of Gratuity Act, 1972. These have been discussed in detail in the next section on 'Social Security in India'.

The important legislations which provide for labour welfare are the Factories Act, 1948; the Mines Act, 1952; the Plantation Labour Act, 1951; the Merchant Shipping Act, 1958; the Motor Transport Workers Act, 1961 and the Coal Mines Labour Welfare Fund Act, 1947. If one goes by the provisions of these Acts, then the welfare facilities to be provided to the workers by the employers of industrial units and other establishments may appear to be quite extensive. However, these facilities can be broadly classified under the following heads: (i) shelters, rest rooms and lunch rooms, (ii) canteen, (iii) facilities for sitting, (iv) washing facilities, (v) facilities for storing and drying clothes, (vi) first-aid-appliances, (vii) creche, (viii) housing, (ix) educational facilities and (x) appointment of a welfare officer.

Bonded Labour System was abolished all over the country from 1976 through the Bonded Labour System (Abolition) Act, 1976. The Act envisaged release of all bonded labourers and discharged them completely from their debt obligations. Under the Act, responsibility for identification, release and rehabilitation of bonded labourers is entirely with State governments.

### **Laws Relating to Trade Unions and Industrial Relations**

The Trade Unions Act was passed in 1926. It provides for registration of trade unions of employers and

workers and in certain respects, defines the law relating to registered trade unions. It confers legal and corporate status on registered trade unions. The Trade Unions Act, 1926 has been amended and following amendments have been enforced from January 9, 2002: (i) no trade union of workmen shall be registered unless at least 10 per cent or 100, whichever is less, of workmen are members of the union; (ii) in no case shall a union be registered without a minimum strength of seven members; (iii) a provision for filing an appeal before the Industrial Tribunal/Labour Court in case of non-registration/restoration of registration has been provided; and (iv) all office bearers of a registered trade union, except not more than one-third of the total number of office bearers or five, whichever is less, shall be persons actually engaged or employed in the establishment or industry with which the trade union is connected.

The Industrial Disputes Act, 1947 strives to pre-empt industrial tensions and provides a mechanism of conciliation, arbitration or adjudication for the settlement of industrial disputes. The Act specifies all those cases in which a strike or a lock-out will be illegal. It also lays down conditions necessary for the legality of strikes and lock-outs. The Act provides for payment of compensation for lay-off and retrenchment of workers. There is also a provision in the Act for the setting up of a Work Committee consisting of the representatives of workers and management in an undertaking for preserving good relations between the management and employees.

### ■■■■ SOCIAL SECURITY IN INDIA ■■■■

Taken in its widest sense, social security means the 'security of the whole society'. This concept is so wide that it encompasses all activities of mankind in all spheres of human life. However, the term as commonly used connotes measures for economic security only under government auspices and such economic security in underdeveloped countries like India does not extend to all members of the society but only to some restricted classes of people like industrial labour, government employees, etc. A coverage of the programmes under social security would be clear from the following definition put forward by Lord William Beveridge, "The term 'social security' is used to denote the security of an income to take the place of earnings when they are interrupted by unemployment, sickness or accident, to provide for retirement through age, to provide for loss of support by the death of another person, and to meet an exceptional expenditure, such as those connected with birth, death and marriage."

*Social security measures involve :*

- (i) *Providing cash payments to persons and families of a specified class whose income from earning has been reduced drastically or ceased temporarily or permanently.*
- (ii) *Providing medical benefits and medical care to persons in the specified class in the event of sickness, maternity, etc.*
- (iii) *Providing cash payments in the form of stipends, pensions, etc. to the dependants of an employee in the event of his death.*

### ■■■■ SOCIAL SECURITY LEGISLATIONS IN INDIA ■■■■

*Social security measures are usually divided into the following two categories: (i) social insurance and (ii) social assistance. Social insurance schemes are usually financed through contribution by the employees, employers and the State. The benefits to insured persons are linked to their contributions. Social assistance schemes seek to provide assistance to the poor and needy persons. They are not linked to the contributions made by the persons and are financed from the general revenues of the State.*

The important social security legislations in India are discussed below.

#### **Workmen's Compensation Act, 1923**

A beginning in social security in India was made in 1923 when Workmen's Compensation Act was passed. The Act covers only workmen in factories and provides for the payment of compensation to them and their families in the case of industrial accidents and of certain occupational diseases arising out of and in the course of employment and resulting in death or disablement. The Act is very wide in coverage and covers many diverse industries including mines, factories, transport, plantations, construction activities, electricity generation etc. but certain specified categories (like members of the armed forces) are excluded. The government can include any class of persons employed in any other hazardous occupation. However, the Act does not apply to those industries or factories where Employees' State Insurance Act, 1948, is in operation. **Prior to Amendment Act of 1984 the term "workman" covered only persons employed on wages not exceeding Rs. 1,000 p.m. However**

*the WC (Amendment) Act, 1984, has done away with the salary restriction and thus any person who is employed in any capacity stipulated in Schedule II will be included in the definition irrespective of the wages drawn by him.* Minimum rate of compensation for permanent disablement and death have been fixed at Rs. 90,000 and Rs. 80,000 respectively. Maximum amount for death and permanent total disablement can go upto Rs. 4.56 lakh and Rs. 5.48 lakh respectively depending on wages of workmen.

### **Maternity Benefit Act, 1961**

The Maternity Benefit Act, 1961, regulates the employment of women in certain establishments for certain period before and after child birth (six weeks before and six weeks after confinement) and provides for maternity and other benefits. The Act also provides that no pregnant women shall, on request being made by her, be required by her employer to do any arduous work one month before her expected delivery. The Act applies to mines, factories, circus industry and plantations, including any such establishments belonging to government, except the employees who are covered under the Employees' State Insurance Act, 1948. It can be extended to other establishments by the State governments. *There is no wage limit for coverage under the Act.*

### **Employees' State Insurance Act, 1948**

The most important step in the field of social security was taken in 1948 when the Employees' State Insurance (ESI) Act was passed. The Act is applicable to non-seasonal factories using power and employing 10 or more persons and non-power using factories employing 20 or more persons. The Act is being gradually extended by the State governments to new classes of establishments, namely shops, hotels, restaurants, cinemas including preview theatres, road motor transport undertakings and newspaper establishments. *The Act covers employees drawing wages not exceeding Rs. 7,500 per month* with effect from April 1, 2004. Persons of armed forces are not covered in the ESI scheme.

**Benefits under ESI.** The ESIC has its own fund known as the ESI Fund. It is utilised for payment of cash benefit to the insured persons, provision for medical benefits under the scheme, establishment of hospitals, dispensaries, etc.

The ESI Act provides the following six major types of benefits to the insured persons—medical benefit, sickness benefit, disablement benefit, maternity benefit, dependants' benefit and the funeral benefit. As far as medical benefit is concerned, it involves free and complete medical care to all insured persons and their families. The person seeking such medical benefit gets free hospitalization, free medical treatment and attendance, free consultation and dispensation, etc. During indoor medical treatment, food is supplied free of cost. As on December 31, 2005 there were 144 ESI hospitals and 42 annexes with 27,097 beds and 1,427 dispensaries under the scheme.

The scheme of sickness benefit provides for periodical cash payments to an insured person in the event of his certified sickness. The benefit is payable for a maximum period of 91 days in any two consecutive benefit periods. However, in certain long drawn-out diseases this period can be further extended. Maternity benefit is payable to an insured woman employee for a period of 12 weeks (six weeks before and six weeks after the date of confinement). Disablement benefit is payable to an employee who suffers an injury resulting into disablement, whether permanent or temporary or who suffers from an occupational disease. The worker is paid for the period for which he is unable to work but if the period is less than three days, no benefit is paid. In the case of permanent disablement, the payment is made for life time and its rate is determined in proportion to the degree of disability as decided by the medical board. Dependants' benefit is paid to the dependants of the employee in the event of an employment injury resulting in the death of the employee. The dependants include the widow, minor children and parents of the deceased. Funeral benefit comprises the payment towards the expenditure on the funeral of the deceased insured person and is payable to the eldest surviving member of his family.

### **Employees' Provident Fund Act and Miscellaneous Provisions Act, 1952**

Retirement benefits are available to the employees under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. The object of this Act is to make: (1) some provisions for the future of the industrial worker after he retires, (2) to provide for the dependants in the case of the employee's death, and (3) to cultivate the spirit of saving among the employees. *The Act covers 180 industries/classes of establishments employing 20 or more persons.* The rate of contribution is 12 per cent in respect of 175 industries/establishments employing 20 or more persons. Under the Act, employers are required to make a matching contribution.

**Refund and Claims.** Under the scheme, a subscriber can withdraw the full amount in the fund in the following cases : (i) retirement from active service after attaining the retirement age; (ii) retirement on account of permanent and total incapacity; (iii) migration from India for permanent settlement abroad; and (iv) termination of service in the course of mass retrenchment. Full amount of employer's contribution with interest is payable only when the subscriber has remained a member of the scheme for at least 15 years. If a subscriber remains member for less than 15 years, only a part of the accumulation of employer's share is payable to him. However, in all cases, he will always get back his own contribution to the Fund.

The scheme also provides for payment of non-refundable advances in certain contingencies like illness of family members, house building, purchasing shares of the Consumers Cooperative Credit Housing Societies, marriage of the member himself or of this dependant, damage to property due to some grave calamity, etc.

### **Employees' Provident Fund Scheme**

The Employees' Provident Fund Scheme seeks to provide financial security for employees in an establishment by providing a system of compulsory savings. The Scheme covers employees getting wages not exceeding Rs. 6,500 per month. As on March 31, 2006, 38,455 new establishments and factories were brought under the purview of the Act. 10.18 lakh new subscribers were enrolled during 2004-05. A Death Relief Fund has been set up under the Employees' Provident Fund Scheme. As per Manual of Accounting Procedure of EPFO, the benefit from the Fund upto Rs. 2,000 is admissible to the nominees/heirs of such of the deceased member whose pay, at the time of death, does not exceed Rs. 1,500 per month, in case the death has occurred on or after April 1, 1988.

### **Employees' Deposit Linked Insurance Scheme, 1976**

The Employees' Deposit Linked Insurance Scheme was introduced for the members of the Employees' Provident Fund and the exempted Provident Funds with effect from August 1, 1976. A special feature of this scheme is that the members are not required to contribute to the Insurance Fund; only the employers and the government are required to make contributions. On the death of a member, the person entitled to receive the provident fund accumulations would be paid an additional amount equal to the average balance in the provident fund account of the deceased during the preceding twelve months. *The maximum amount of benefit payable, under the scheme, is Rs. 60,000.*

### **The Payment of Gratuity Act, 1972**

Gratuity is defined as a lumpsum payment made to a worker or to his heirs by the company on termination of his service due to retirement, retrenchment, invalidity or death. The Payment of Gratuity Act, 1972, is applicable to factories, mines, oil fields, plantations, ports, railways, motor-transport undertakings, companies, shops and other establishments. *The Act provides for payment of gratuity at the rate of 15 days wages for each completed year of service subject to a maximum of Rs. 3.50 lakh.* In the case of seasonal establishment, gratuity is payable at the rate of seven days' wage for each season. The Act does not affect the right of an employee to receive better terms of gratuity under any award or agreement or contract with the employer.

### **Employees' Pension Scheme, 1995**

This scheme was introduced for the industrial workers with effect from November 16, 1995. Under the Scheme, pension at the rate of 50 per cent pay is payable to the employees on retirement/superannuation on completion of 33 years' contributory service. A minimum 10 years' service is required for entitlement to pension. Depending upon the salary and service of the employee at the time of death the scheme also provides for grant of family pension ranging from Rs. 450 per month to Rs. 2,500 per month. In addition, children-pension at the rate of 25 per cent of widow pension subject to a minimum of Rs. 150 per child is also payable upto two children. The scheme is financed by diverting the employer's share of provident fund representing 8.33 per cent of the monthly wage to the pension fund. In addition, the Central government also contributes to the scheme at the rate of 1.16 per cent of wage. The upper limit has been raised from Rs. 5,000 to Rs. 6,500 with effect from June 1, 2001.

Details of labour laws awaiting Parliament's approval as in November 2007 are presented in Box 45.1.

**BOX 45.1. Labour Laws Awaiting Parliament's Nod****The Apprentices (Amendment) Bill**

*Status:* Introduced in the Rajya Sabha in May 2005. Passed in the last session of Parliament.

*What it Aims at:* Reservation for other backward classes in designated trades.

**Comprehensive Amendments to Factories Act, 1948**

*Status:* The labour ministry is still engaged in consultations.

*What it Aims at:* To introduce flexibility in working hours and reduce inspections by labour inspectors.

**Factories (Amendment) Bill**

*Status:* Introduced in August 2005. Expected to be taken up in the coming session of Parliament.

*What it Aims at:* Permit women to work in night shifts with defined safeguards in work-place relating to transport and other facilities.

**Payment of Bonus (Maternity Benefit (Amendment) Bill)**

*Status:* Expected to be taken to the Cabinet.

*What it Aims at:* Raise medical bonus from Rs. 250 to Rs. 1,000 and enable revisions up to a maximum of Rs. 20,000.

**Employment Exchanges (Compulsory Notification of Vacancies) Act, 1959 (Amendment) Bill**

*Status:* Pending with the Ministry of Law and Justice for vetting.

*What it Aims at:* To make it compulsory for all establishments, both government and private, to advertise vacancies in government-run employment exchanges.

**Industrial Disputes (Amendment) Bill**

*Status:* Sent to the Ministry of Law and Justice for comments. Expected to be taken up in the Cabinet soon.

*What it Aims at:* To change provisions relating to layoff and retrenchment of workers and payment of compensation.

**Plantation Labour (Amendment) Bill**

*Status:* Draft Cabinet note circulated among the Ministries and States with plantations.

*What it Aims at:* To safeguard safety and health of workers in plantations and impose more obligations on plantation owners.

**Participation of Workers in Management Bill**

*Status:* Introduced in the Rajya Sabha in May 1990. Still being considered by the government.

*What it Aims at:* To include workers on boards of management of companies.

**Amendment to Minimum Wages Act, 1947**

*Status:* The Central Advisory Board being reconstituted to discuss the proposals.

*What it Aims at:* Proposes a uniform minimum wages law all over the country.

**The Unorganised Sector Workers: Social Security Bill**

*Status:* Introduced in the last session of Parliament and referred to the Parliamentary Standing Committee on Labour.

*What it Aims at:* Provide health insurance, life and accident insurance, maternity benefits and old-age pension to workers in the unorganised sector.

**Payment of Gratuity (Amendment) Bill (To Cover the Teachers in Educational Institutions under The Act of 1972)**

*Status:* Expected to be introduced in the forthcoming session of Parliament.

*What it Aims at:* Ensure teachers are entitled to gratuity.

**Labour Laws (Exemption from Furnishing Returns and Maintaining Registers by Certain Establishments) Amendment and Miscellaneous Provisions Bill**

*Status:* Introduced in August 2005. The Cabinet approved it in October 2007.

*What it Aims at:* Exempt establishments with up to 40 workers from maintaining registers. This limit was previously 19.

*Source:* *Business Standard*, November 3, 2007, p. 3.

**■■■■ A CRITICAL REVIEW OF SOCIAL SECURITY MEASURES IN INDIA ■■■■**

As would be clear from the brief review of social security legislation in India, the government has undertaken various steps in the post-Independence period to provide social security to employees. However, we have only made a start so far and much needs to be done as would be clear from the following discussion.

**1. Insufficient coverage.** The most important criticism of the social security measures undertaken by the government is their totally insufficient coverage. A majority of the people continue to remain outside the ambit of social assistance and social insurance schemes. For example, as per the survey carried out by the National Sample Survey Organisation in 1999-2000, the total employment in both organised and unorganised sectors in the country was of the order of 39.9 crore, *i.e.*, around 2.8 crore in the organised sector and the balance 37.1 crore (about 92.0 per cent) in the unorganised sector.<sup>6</sup> *No social security scheme worth the name is available for the workers in the unorganised sector.*<sup>7</sup> Particularly miserable has been the condition of 23.9 crore workers employed in the unorganised sector in agriculture (of the total 37.1 crore workers employed in the unorganised sector) who have irregular employment and no land or property to fall back upon. Even in the organised sector, only persons working in establishments employing more than 20 persons are covered under most of the social security schemes.

In addition to workers employed in organised and unorganised sectors, *there are a large number of 'unemployable people'* — old and sick people, persons suffering from various disabilities etc. No social security measures worth the name have been undertaken for this class of people. However, in recent times, the government is trying to provide some semblance of social security to these people by introducing old age



pension schemes and health insurance schemes (for example, the four public sector general insurance companies launched a community-based 'Universal Health Insurance Scheme' in July 2003). For old persons an 'Integrated Programme for Older People' is being implemented which includes setting up of old age homes, day care centres and introducing mobile medicare units.

**2. No unemployment insurance.** In many developed countries, there is provision for unemployment insurance. Benefits under such schemes are available to those individuals who are able to work and are available for work (as evidenced by registration at a public employment office). Such insurance enables the individual to meet his minimum subsistence requirement during the period he is seeking employment. However, because of the immense economic costs of this scheme, most of the underdeveloped countries (including India) have found it difficult to implement it. What we have in our country is a provision for retrenchment and lay-off compensation which does not even touch a fringe of the problem. Unless something is done to provide unemployment insurance, economic security cannot be achieved and in the absence of economic security, social security will also remain a dream.

**3. Overlapping of schemes.** India does not have an integrated scheme of social security. On account of this reason, there is considerable overlapping of schemes and similar benefits are being disbursed under various schemes. This results in wastage of effort and money. Though the idea of integrating the various schemes has been mooted at various seminars and discussions, nothing concrete has been done in this direction so far with the result that different schemes of practically the same nature continue to be administered by different agencies.

**4. Inadequate facilities in relation to the needs of beneficiaries.** The social security schemes are woefully inadequate in relation to the demand for them by the beneficiaries. For example, the medical and dispensing facilities available under the ESI schemes are very insufficient. The number of dispensaries and hospitals is much less than desired. Even the dispensaries and hospitals that exist are understaffed. The beneficiaries are put to a lot of trouble and botheration. There is overcrowding in the dispensaries and hospitals and their staff finds it difficult to cope with the demand on this service. Naturally they get irritated and their behaviour towards patients is anything but cordial.

The critical review of the social security schemes in India suggests that there is a need to widen their coverage so that a majority of the people who continue to be outside their ambit are brought within it. There is also a need to bring about a qualitative improvement in the services provided, introduce unemployment insurance and bring about an integration amongst the various social security schemes.

#### ■■■■ NOTES ■■■■

1. Government of India, *Economic Survey 2006-07* (New Delhi, 2007), Table 7.14, p. 152.
2. Calculated from CSO, *Statistical Abstract of India 2003* (New Delhi, 2004), Table 24.20, p. 312.
3. *Ibid.*, Table 24.14, p. 305 and Table 26.2, p. 342.
4. S.C. Kuchhal, *The Industrial Economy of India* (Allahabad, 1976), p. 444.
5. V.V. Giri, *Labour Problems in Indian Industry* (Mumbai, 1972), p. 137.
6. S. Sakthivel and Pinaki Joddar, "Unorganised Sector Workforce in India," *Economic and Political Weekly*, May 27, 2007, Table 1, p. 2108 and Table 3, p. 2109.
7. The National Commission for Enterprises in the Unorganised Sector (NCEUS) submitted a report to the government on social security for unorganised workers on May 16, 2006. The scheme seeks to provide social security to 30 crore unorganised workers to be covered in a period of 5 years.

# IMPLICATIONS OF ECONOMIC REFORMS FOR LABOUR MARKETS IN INDIA

## *Implications of Economic Reforms for Labour Markets: Some Conceptual Issues*

### *Economic Reforms and Labour Market In India*

• Economic Reforms and Employment • Exit Policy, VRS and Redundancies • Increase in the Share of Contractual and Casual Workers • The Move Towards Low Paid, Low Quality Jobs • FDI and Labour Markets

### *Economic Reforms and Safety Net for Labour*

• Labour Redundancies and National Renewal Fund • Programmes for Providing Employment • Social Security for Labour

### *Conclusion*

The Government of India has introduced a number of liberalisation measures in the various sectors of the economy (particularly in the industrial, financial and foreign trade sectors) since 1991. It has also been undertaking a variety of measures to 'integrate' the Indian economy into the global economy. These reforms tend to influence the structural traits of production process in different sectors of the economy. These structural shifts, in turn, can influence the various dimensions of the labour markets such as employment levels, wage rates, labour productivity, intersectoral labour flows, labour demand structure, and so on. In this chapter we propose to examine the impact of economic reforms on the Indian labour market. In particular, we emphasize the adverse effects of economic reforms on labour employment as it is mostly in this context that the debate is being carried out in India. The important issues addressed in this chapter are as follows:

- Implications of economic reforms for labour markets: some conceptual issues
- Impact of economic reforms on labour market in India.
- Social safety net for workers.

## ■■■■ IMPLICATIONS OF ECONOMIC REFORMS FOR LABOUR MARKETS: SOME CONCEPTUAL ISSUES ■■■■

V.R. Panchamukhi, Nagesh Kumar and Ram Upendra Das discuss the implication of economic reforms on the labour market under the following headings<sup>1</sup> :

- Mismatch between demand and supply of labour
- Adoption of labour displacing technologies
- Pressures on wage levels
- Openness, labour productivity, and employment
- Labour market consequences of privatisation
- Influence of trade liberalisation, exports, and FDI on employment.

1. **Mismatch between demand and supply of labour.** Increasing liberalisation of the industrial sector leads to more and more intense competition between enterprises. Thus the enterprises tend to focus more on

the productivity of labour by using modern technologies. Handling of new technologies requires different types of skilled labour than is available in the labour markets. Moreover, many workers start shifting from less competitive jobs to more competitive ones. This leads to 'relocation' of economic activities and can make labour engaged in some activities redundant. As a result of these trends, there emerges a mismatch between the demand for and the supply of labour. The problem is aggravated by the fact that while demand patterns can change in very short periods, the supply of labour has a long gestation lag.

**2. Adoption of labour displacing technologies.** Because of the competitive pressures, the enterprises try more and more to improve their efficiency and cut down on the production costs. Generally the first effort in the cost cutting exercise is to reduce labour costs by adopting labour displacing technologies. If foreign direct investment inflows assume more importance, these trends are strengthened as MNCs generally bring in a highly capital intensive technology. As domestic enterprises brace themselves to face the competition from MNCs, they also are forced to adopt more and more capital intensive and labour displacing technology.

**3. Pressure on wage levels.** With increasing global integration and liberalisation measures, pressures on wage levels across different categories of workers are felt. This can happen due to a variety of reasons, the two most important being: (i) the capacity of the MNCs to pay better wages *vis-a-vis* domestic entrepreneurs, and (ii) shift in the demand for labour from unskilled to skilled. Panchamukhi, Kumar and Das hypothesise that if wages rise faster than the rate of increase of output, the domestic entrepreneurs would be prompted to adopt more and more labour saving techniques of production.<sup>2</sup>

**4. Openness, labour productivity, and employment.** As stated earlier, in a globalised and open economic environment, competitive pressures force enterprises to focus on modernisation efforts and efficiency gains. As a result, efforts are made to raise labour productivity levels. However, labour productivity gains can have two conflicting effects on employment levels: (i) employment expansion, and (ii) employment contraction. In case openness provides opportunity for scale expansion, labour productivity gains can lead to a higher scale of operation. This can result in employment expansion. However, if scale expansion is not possible either due to protectionist policies of the destination countries or due to global demand constraints, labour productivity gains can result in lower demand for labour per unit of output which can, in turn, reduce the level of employment.<sup>3</sup>

**5. Influence of trade liberalisation, exports and FDI on employment.** Trade liberalisation by opening up the floodgates of imports can have serious adverse implications for labour employment. Several domestic companies that face the heat of competition from imported goods may fail to withstand competitive pressures from imports and close down. This can result in an increase in unemployment levels.

As far as export expansion and increase in FDI (foreign direct investment) is concerned, they are acknowledged by many economists as the positive outcomes of the development strategy based on outward-orientation. However, as correctly pointed out by Panchamukhi, Kumar and Das, they ought to be regarded as 'instruments' of development and not an end in themselves. Unless these instruments bring in employment and income effects, an economy's growth process would not pick up as desired.<sup>4</sup> *It often happens that in a bid to improve their competitive strength, manufacturers of export commodities start adopting capital intensive and labour displacing technology. This can have an adverse effect on the employment levels in the industrial sector.* As far as the effect of FDI on the overall employment situation in a country is concerned, much depends on the production technique foreign enterprises adopt. In general, the production techniques adopted by foreign enterprises (particularly by MNCs) are expected to be highly capital intensive and labour displacing. As the production base of these companies expands in the domestic economy, a large number of workers are likely to lose their jobs. This is due to the reason that an important way of expansion adopted by these companies is by acquiring and taking over the reins of domestic companies. Such acquisition and takeover is followed by the introduction of capital intensive technology making a large number of workers redundant. With automatic machines, the production process in a unit can be carried on with a handful of workers rendering many workers surplus who could then be retrenched.<sup>5</sup> The danger is not limited to the workers of the companies acquired by the MNCs. As local companies adopt similar practices to improve their competitive strength to face the competition from companies acquired by MNCs, labour retrenchment could increase over a wide spectrum of industrial activities.

## ■■■■ ECONOMIC REFORMS AND LABOUR MARKET IN INDIA ■■■■

In this section we propose to discuss the impact of economic reforms on labour market in India. The discussion is divided into following parts:

- Economic reforms and employment
- Exit policy, VRS and redundancies
- Increase in the share of contractual and casual workers
- The move towards low paid, low quality jobs
- FDI and labour markets.

### Economic Reforms and Employment

To study the impact of economic reforms on employment generation consider the data contained in Table 46.1.

TABLE 46.1. Employment and Unemployment (by Usual Principal Status)

	1983	1993-94	1999-2000	2004-05	Growth rate in per cent per annum		
					1983 to 1993-94	1993-94 to 1999-2000	1999-2000 to 2004-05
	(million)						
Labour force	277.34	343.56	377.88	428.37	2.06	1.60	2.54
Work force	269.36	334.54	367.37	415.27	2.09	1.57	2.48
Number of unemployed	7.98	9.02	10.51	13.10	—	—	—
	As a proportion of labour force in per cent						
<b>Unemployment rate</b>	<b>2.88</b>	<b>2.62</b>	<b>2.78</b>	<b>3.06</b>			

Source : Government of India, *Economic Survey, 2006-07* (New Delhi, 2007), Table 10.4, p. 208.

As a clear from Table 46.1, the annual employment growth rate fell drastically from 2.09 per cent during 1983 to 1993-94 to 1.57 per cent during 1993-94 to 1999-2000. However, this rate improved considerably to 2.48 per cent over the period 1999-2000 to 2004-05. But because of higher increase in labour force, *the unemployment rate in 2004-05 was as high as 3.06 per cent of the labour force* as against 2.78 per cent in 1999-2000. *As far as absolute level of unemployment is concerned, it has risen considerably over the period 1983 to 2004-05 from 7.98 million to as high as 13.10 million.*

Employment generation in the organised sector has suffered a setback in the post-reform period as would be clear from the following Table reproduced from *Economic Survey, 2006-07*.

TABLE 46.2. Annual Growth of Employment in Organised Sector

	(in per cent)	
	1983 to 1993-94	1994 to 2004
Public Sector	1.53	-0.80
Private Sector	0.44	0.61
<b>Total organised</b>	<b>1.20</b>	<b>-0.38</b>

Source : Government of India, *Economic Survey, 2006-07* (New Delhi, 2007), Table 10.6, p. 211.

As is clear from this Table, the rate of growth of employment in the organised sector as a whole, which was 1.20 per cent per annum over the period 1983 to 1993-94 turned negative over the period 1994 to 2004 and was -0.38 per cent per annum during this period. This was basically due to a steep fall in the growth rate of employment in the public sector.

*These trends of increasing unemployment in the country are to be viewed against the backdrop of accelerated economic growth in the economy.* This can be explained in terms of steady decline in employment elasticity in all the major sectors of economic activity except in construction. For example, in manufacturing, employment elasticity declined from 0.38 during 1983 to 1993-94 to 0.33 during 1993-94 to 1999-2000. In agriculture, the decline was from 0.70 during 1983 to 1993-94 to only 0.01 during 1993-94 to 1999-2000. The overall employment elasticity (all sectors combined) was 0.52 during 1983 to 1993-94 and this fell to only 0.16 during 1993-94 to 1999-2000.<sup>6</sup>

**Causes for Fall in Rural Employment Growth.** As is clear from the data above, there has been a steep decline in the employment elasticity of the agricultural sector in recent times. According to T.S. Papola, the

decline in employment elasticity in the agriculture “is found to be due primarily to the sharply declining and even negative elasticities in a few regions — Punjab, Haryana and Uttar Pradesh — where the green revolution has resulted in significant yield and output growth. The growth in the initial years was contributed mainly by expansion of gross cropped area through an increase in cropping intensity, facilitated by irrigation and availability of short duration high yielding varieties. After that source was exhausted, output growth became more input and technology-intensive and less labour intensive.”<sup>7</sup>

Another important reason for the drastic fall in the growth rate of employment in agriculture in 1990s has been the decline in the share of agriculture sector’s capital formation in GDP from 1.9 per cent in the early 1990s to 1.3 per cent in the early 2000s. This declining share was due mainly to the stagnation or fall in public investment in agriculture particularly since the mid-1990s (public investment in agriculture fell from Rs. 4,947 crore in 1994-95 to Rs. 3,927 crore in 2000-01 at 1993-94 prices though it picked up slightly in subsequent years). Public investment in agriculture mostly takes place in medium and major irrigation projects, rural roads, markets, storage etc. all having considerable employment potential. Therefore fall in public investment in agriculture during 1990s must have contributed significantly to a fall in the growth rate of employment in rural areas. C.P. Chandrasekhar and Jayati Ghosh draw attention to another fact. According to them, reduced transfers to State governments in 1990s meant that they faced a major financial crunch and were therefore forced to cut back their own spending, particularly on social expenditure such as on education and on health and sanitation, which had provided an important source of public employment over the 1980s.<sup>8</sup>

**Causes for Fall in Urban Employment Growth.** Some economists have blamed ‘rigidities’ in the labour market for fall in urban employment growth. According to these economists, such rigidities are of two types: (i) job security provisions, and (ii) lack of any relation between productivity and wages. It is argued that because of job security provisions, there is an ‘inflexibility’ in the labour market which discourages enterprises (particularly in the large organised sector) from expanding employment as they fear that it will not be possible for them to reduce employment in future if exigencies of competition demand so at some later date. As far as the impact of wage increase is concerned, it is argued that the faster growth of industrial wages relative to consumer prices for industrial workers (abetted by union militancy and job security provisions) has contributed to reduction in the long term growth of employment.

However, studies by T.S. Papola have shown that real wage increases in the Indian manufacturing sector has not been a factor inducing the adoption of capital-intensive technologies by the employers as high increases in real wages were generally closely associated with high increases in labour productivity across industry groups. Nagraj has argued that the wage rate per worker day has increased at a very low pace in real terms and could not have been the cause for induction of capital intensive technologies. In fact, large corporate sector has not even made wage increase their main target of reform in the labour market.

Thus slow growth of employment in the aggregate cannot be attributed to protective labour legislation and unionism. The fall in urban employment growth rate is basically due to a collapse in public sector employment where the emphasis has been on downsizing (in fact, employment in public sector fell from 195.59 lakh persons in 1997 to 181.94 lakh persons in 2004), and the increasing difficulties being faced by the small scale producers who account for not only the most labour-intensive forms of urban production but also the dominant part of urban manufacturing employment. Under the new economic policies being pursued with vigour since 1991, there has been a reduction in priority sector allocation of credit, decline in public investment in infrastructure, removal of various export subsidies from which small-scale exporters benefited, and sharp reductions in import tariffs which have brought down the prices of imported goods drastically. All these factors have adversely affected the viability of small scale units. The small-scale producers are finding it difficult to compete with qualitatively better and money-wise cheaper foreign goods. Neither can they ever hope to meet the huge advertising budgets of foreign companies and MNCs. All these factors are forcing many small-scale enterprises to close down their operations rendering a large number of workers unemployed. In fact, as at end March 2003, as many as 1.68 lakh small-scale industrial units were sick of which as many as 1.63 lakh were classified as non-viable.<sup>9</sup>

### Exit Policy, VRS and Redundancies

The supporters of neoliberal approach have been arguing that the success of new liberal economic policies requires labour market reforms as labour market flexibility is necessary to ensure efficient industrialisation. Put in simple terms, the private sector should be allowed the freedom to ‘hire and fire workers’. It is also said that the public sector enterprises, banks etc. are overstaffed and, therefore, a reduction in staff strength is

required to improve efficiency levels. The proposal for introducing such an exit policy was first mooted in September 1991. *The World Bank and the IMF have also been insisting for quite some time that the government should introduce labour market reforms to allow employers shift workers from one unit to another and also retrench excess labour.*

Following this 'advice', many companies in the large corporate sector and many public sector enterprises have opted for retrenchment of labour through the announcement of VRs (Voluntary Retirement Schemes). For example, a study by Business Standard Research Bureau published in 2001 showed that 23 manufacturing companies accounting for 17 per cent of the total sales of the private manufacturing sector cut their workforce by a whopping 40,338 in 2000-01 over 1998-99, *i.e.* in a matter of just two years.<sup>10</sup> This trend has gathered still more momentum in recent times. In fact, the growth in the recent phase of revival of the corporate sector has been 'labour saving' to an extreme degree. Improvement in operating efficiency has been due to dramatically reduced workforce and wage bill. Roach has recently presented data for two top vehicle manufacturers of the country—Tata Motors and Bajaj. In 1994, Tata Motors produced 1,29,400 vehicles with 35,000 workers. In 2004, it produced 3,11,500 vehicles with just 21,400 workers. In the mid-nineties, Bajaj produced a million scooters with a workforce of 24,000. Today it produces 2.4 million vehicles with a labour-force of 10,500.<sup>11</sup> According to official estimates, Indian companies as a whole shed over 8,70,000 jobs during 1990s. Thus what we see is corporate sector's *jobless recovery* in recent times with jobs actually declining instead of increasing with industrial growth. The 'competitive advantage' of India's manufacturing sector in recent period went directly against the country's 'comparative advantage', its low cost of labour. Indian manufacturers have increasingly substituted capital for labour despite labour's low cost.

The public sector enterprises have resorted to still larger job cuts through the VRS route. In a period of three years (1997 to 2000), six blue-chip public sector units which include Steel Authority of India Ltd. (SAIL), Coal India Ltd. (CIL), Bharat Heavy Electricals Ltd. (BHEL), Hindustan Zinc Ltd. (HZL) and Oil and Natural Gas Corporation (ONGC) axed 1,20,000 jobs.<sup>12</sup> CIL alone cut jobs by 90,000 and SAIL by 20,000. Public sector banks (like State Bank of India, Indian Overseas Bank, Punjab National Bank, Bank of India, Indian Bank, Syndicate Bank, Central Bank of India etc.) have also seen the exit of more than one lakh employees through the VRS route. Gopal Joshi's study of privatisation programme in India (published in 2000) suggests that 23 per cent jobs in public sector enterprises have been made redundant under voluntary retirement schemes following privatisation.<sup>13</sup>

#### BOX 46.1. Government Mulls Scheme to Make Lay-Offs Easier

- In a significant move towards labour law reform, negotiations have been reopened on the hire and fire policy with the government offering a scheme of insurance coverage for retrenched workers to overcome objections from trade unions.
- To make the amendment acceptable to the trade unions, which have steadfastly refused to accept any relaxation of the hire and fire rules under the Industrial Disputes Act, the Labour Minister Oscar Fernandes has suggested a new formula to industry —
  - (i) The industrial unit will make an advance calculation of the size of work force required to be retrenched every year. Compensation per head, instead of being disbursed individually, will be handed over to the government as an accumulated amount. The corpus will serve as the premium for an insurance scheme that will generate a better package for retrenched workers.
  - (ii) To work out the details of this scheme, the Labour Ministry plans to set up a tripartite committee with government, employers and trade union representatives.
  - (iii) Employers have agreed to provide compensation amounting to 45 days' wages per year of service to the workers — which is industry's best offer so far. Under the Industrial Disputes Act, 15 days' wages per year of service is to be given to any retrenched worker. The Second National Commission on Labour in 2002 had recommended 30 days' wages per year of service.
- Trade unions have opposed the scheme as the intention of the government is to link the scheme with amendment in the Industrial Disputes Act which envisages raising the limit of workers in loss making units (the current law enables units employing upto 100 workers to close without government permission. This threshold limit was proposed to be increased to 1,000 workers in the Union Budget 2001-02 but this was never implemented because of the opposition from trade unions).
- Trade unions feel that if the threshold limit for easy closure and retrenchment is extended to more workers, 80 per cent of establishments in India will become vulnerable.

Source : *Business Standard*, November 3, 2007, p. 1.

The above discussion shows that companies are turning 'lean and mean' to increase their profit margins. Because of the increasing threat from foreign competition, the domestic companies are now focusing more on 'core competency' and less on diversification. They are, accordingly, trying to pullout of unrelated and unprofitable

businesses. VRS is also adopted by companies when they form strategic alliances with other companies or there is a takeover. *Hapless workers are the victim of the process of consolidation, restructuring, mergers, acquisitions and amalgamations which is sweeping the Indian corporate sector presently.*

### Increase in the Share of Contractual and Casual Workers

*As a result of liberalisation and privatisation, the dualism in the labour market has increased.* According to an estimate, the share of permanent manual workers declined from close to 68 per cent in 1991 to 64 per cent in 1998. Not only did the share of non-permanent workers increase but the share of the casual among non-permanent workers increased even faster. Holding all other factors constant, firms that employed 50-99 workers as also those that employed 500 or more workers, increased the share of non-permanent workers significantly between 1991 and 1998. Also, firms employing 500 workers or more increased the share of temporary workers.<sup>14</sup> Many firms have resorted to the practice of employing contractual labour. For example, it has been estimated that 20,000 jobs have been contractualised by nine top performing public sector enterprises called *Navratnas*. The increasing trends of casualisation and contractualisation of labour have weakened the labour unions considerably and many seem to have reconciled to the inevitability of adjustments in workforce in the face of globalisation and industrial restructuring.

### The Move Towards Low Paid, Low Quality Jobs

As is clear from Table 46.1 the Indian economy created about 80 million jobs between 1993-94 and 2004-05 (as the workforce increased from 334.54 million in 1993-94 to 415.27 million in 2004-05). However, what is a matter of concern is the fact that *95 per cent of these jobs were created in India's unorganised sector*—mainly tiny outfits like the neighbourhood shop which employs less than 10 workers and does not keep regular accounts. Even in rural India (which accounts for three quarters of the Indian working class) the vast majority work in unorganised sector enterprises. Many workers who are opting for VRS in large corporate enterprises are also joining the unorganised sector (thus there is a reverse flow from the organised sector to the unorganised sector).

Jobs in the unorganised sector are low paid, low quality jobs with no social security whatsoever. *It has been estimated that the productivity of 70 per cent of the jobs in the rural unorganised sector is too low (below Rs. 1,000 per month) to sustain the average worker, unless he or she works in other jobs.*<sup>15</sup> Thus more than 16 years after liberalisation, the vast majority of Indians are still trapped in low-quality jobs that can barely sustain them and their families. And these jobs offer no security. This is the reason why although India's official unemployment rate is only around 7 per cent, the official poverty rate is far higher at 26 per cent (some researchers have estimated the poverty rate to be much higher than even 26 per cent). Many of those employed cannot earn enough to keep their families above the poverty line.

The problem of Indians being trapped in low quality jobs is likely to get dramatically worse. The Planning Commission estimates that about 80 million people will join the labour force by 2012. It estimates that if things continue as they are, the number of unemployed could rise to 48 million by 2012 even if the economy grows at 8 per cent per year. Given the current patterns, a large number of those who are lucky to get jobs will probably end up in low-paid and low-quality jobs in the unorganised sector.

### FDI and Labour Markets

We have already pointed out three distinct characteristics of FDI operations in the developing countries: (i) the FDI affiliates adopt capital intensive and labour saving techniques of production; (ii) there is a tendency to employ skilled and qualified labour in place of unskilled workers; and (iii) in the domestic companies acquired by MNCs, restructuring of operations and rationalisation of workforce is undertaken. All these characteristics imply that *with an expansion of FDI activities in the developing countries, unemployment among unskilled workers is likely to increase although wages for skilled workers of specified categories could rise.*

Panchamukhi, Kumar and Das make two other observations which are of considerable relevance: (i) foreign firms in India have significantly greater extent of vertical integration as compared with local firms. Thus FDI may generate fewer interfirm linkages than domestic investments. This in turn would imply that indirect employment generation by per unit of FDI is lower than that by domestic investments (in this context, 'enclave' type nature of FDIs in EPZs (Export Processing Zones) is often emphasised which has generated little linkages with the rest of the economy); and (ii) FDI *crowds out* domestic investment. In this context, they quote a study by Kumar and Pradhan published in 2002 which shows that FDI crowds out domestic investment in net terms

in 29 countries out of a sample of 52 developing countries. Authors of the study have found that in India's case too the crowding out effect appears to prevail in net terms although the relationship was not significant in statistical terms.<sup>16</sup>

Thus, an increasing exposure to FDI is likely to bring about a number of changes in the labour market. The labour market is expected to favour highly skilled personnel and higher average wages, although the number of jobs created per unit of capital may actually decline. The indirect effect of FDI on employment generation through growth also seems to be insignificant, if at all positive.

### ■■■■ ECONOMIC REFORMS AND SAFETY NET FOR LABOUR ■■■■

Because of the adverse effects of economic reforms and industrial restructuring on labour, it is necessary to provide a social safety net for labour. Keeping this objective in view, the Government of India has introduced some specific measures. In this section we propose to discuss these measures under the following headings:

- Labour redundancies and National Renewal Fund
- Programmes for providing employment
- Social security for labour

#### Labour Redundancies and National Renewal Fund

To tackle the problems relating to labour redundancies and retrenchment of employees, the Government of India soon after initiating the economic reforms in 1991 set up the National Renewal Fund (NRF). Inaugurated in February 1992, the objectives of NRF were as under:

1. To provide assistance to firms to cover the costs of retraining and redeployment of employees arising as a result of modernisation and technological upgradation of existing capacities and from industrial restructuring.
2. To provide funds for compensation to employees affected by restructuring or closure of industrial units, both in the public and private sectors.
3. To provide funds for employment generation schemes in the organised and unorganised sectors in order to provide a social safety net for labour.

NRF had three components: (i) the Employment Generation Fund (EGF), (ii) the National Renewal Grant Fund (NRGF) and (iii) the Insurance Fund for Employees (IFE). EGF was meant to provide resources for employment generation schemes in both organised and unorganised sectors. NRGF was meant to deal with payments under the Voluntary Retirement Scheme (VRS) and compensation to workers affected by closure/ rationalisation resulting from approved rehabilitation schemes in both the public and private sector enterprises. IFE was expected to cater to the compensation needs of the employees in future.

The main criticism against the NRF is that it remained a fund for financing VRSs solely in the central public sector undertakings. In other words, only the NRGF component of the NRF was operationalised and that too partially. While the main objective of NRF was to help in training, counselling, and redeployment of affected workers, and also employment generation, 92.8 per cent of the NRF expenditure was utilised for compensation payment under VRS till 2000-01 (NRF was abolished vide Government of India notification dated July 12, 2000). This prodded the trade unions into labelling NRF as the National Retirement Fund.<sup>17</sup>

This shows that only 7.2 per cent of the NRF was used for non-VRS activities like survey of workers, counselling, retraining, and redeployment over the entire period of operation of NRF (1992-93 to 2000-01). Data show that only about 40 per cent VRS avalees were retrained and merely 13.7 per cent could be redeployed under NRF.

*Displacement of a large number of the workers through the mechanism of VRS without equipping them with adequate skill and training to re-enter the job market, has resulted in a huge loss of productive manpower.* Many workers who exited the manufacturing sector through the VRS route have joined the unorganised sector as 'new poor'. A study by Roy Chaudhary (1996) finds that 25 per cent of the displaced workers who are working as casual labourers, are not employed even for a full week. Noronha (1999) finds that displaced workers also face income loss — the average income of these re-employed dropped by about 44 per cent. Data (2001) finds that though more than half the VRS avalees could have found employment within a period of six months, most of them took self-employment in agriculture in their native village. "This is a social waste of human potential and raises question about the 'training' objectives of the NRF."<sup>18</sup>



## Programmes for Providing Employment

The most important safety net for workers is the provision of employment. With this end in view, the government operationalised a number of employment programmes since the beginning of 1980s. After economic reforms, some new programmes have also been introduced and restructuring of the old programmes has also been undertaken. While some programmes are self-employment programmes, some others are wage employment programmes. A brief description of the various employment programmes follows:

The *National Rural Employment Programme (NREP)* was started as part of the Sixth Plan and was continued under the Seventh Plan. On April 1, 1989 it was merged into the Jawahar Rozgar Yojana. The NREP was meant to help that segment of rural population which largely depends on wage employment and has virtually no source of income during the lean agricultural period. Under the NREP development projects and target group oriented employment generation projects were closely intertwined. The programme was implemented as a centrally-sponsored scheme. But its financial burden was to be shared between the Central government and the State governments on 50:50 basis. Under the scheme a district level employment plan (disaggregated block-wise) was prepared. This plan was required to estimate the number of persons who would seek work under the scheme and the work opportunities likely to be available. The programmes of works under the NREP were formulated in the light of this information.

The *Rural Landless Employment Guarantee Programme (RLEGP)* was started on 15th August, 1983, with the objective of expanding employment opportunities for the rural landless. The programme aimed at providing guarantee of employment to at least one member of the landless household for about 100 days in a year. Under this scheme infrastructural development was undertaken with a view to create employment opportunities for the rural landless. Though the programme was to be fully financed by the Central government, the implementation of the programme was entrusted to the States.

The *Integrated Rural Development Programme (IRDP)* launched in 1978-79 and extended all over the country in 1980-81 was essentially conceived as an anti-poverty programme under the Sixth Five Year Plan. It, however, through a programme of asset endowment also meant to provide self-employment in a variety of activities like sericulture, animal husbandry and land-based activities in the primary sector; weaving, handicrafts, etc., in the secondary sector; and service and business activities in the tertiary sector. Under the Sixth Plan the IRDP aimed at covering 15 million families in all the blocks of the country. Thus, on an average, about 3,000 families in a block were expected to receive assistance under this programme. The assets provided to these households were financed through a mix of government subsidy and institutional credit on an average subsidy-credit ratio of 1:2. Under the IRDP, 38.2 million families were assisted.

*Swaranjayanti Gram Swarozgar Yojana (SGSY)* was launched from April 1, 1999 after restructuring the IRDP and allied schemes. It is the only self-employment programme for the rural poor. The objective is to bring the self employed above the poverty line by providing them income generating assets through bank credit and government subsidy. Upto December 31, 2006, 24.38 lakh self-help groups (SHGs) have been formed and 73.25 lakh swarozgaries have been assisted with a total outlay of Rs. 16,444 crore.

The *Scheme of Training Rural Youth for Self-Employment (TRYSEM)* was initiated in 1979 with the objective of tackling unemployment problem among the rural youth. It aimed at training about 2 lakh rural youths every year to enable them to become self-employed. Under this scheme 40 youths were to be selected from each block and for being eligible for selection, the person should belong to a rural family having an income less than Rs. 3,500 per year. In making selection, members of scheduled castes and scheduled tribes were given preference. Under the scheme a minimum of one third of the rural youths trained were to be women. The TRYSEM was merged into Swarnajayanti Gram Swarozgar Yojana in April 1999.

In February 1989 the government announced a new wage employment scheme, the *Jawahar Lal Nehru Rozgar Yojana* for intensive employment creation in 120 backward districts. However, later on it was felt that there was no need to have the separate NREP, RLEGP and the Jawahar Lal Nehru Rozgar Yojana. These wage employment programmes had the same objective and similar thrust. Therefore, these programmes were merged into a single rural employment programme on April 1, 1989 and it was given the name *Jawahar Rozgar Yojana (JRY)*.

The JRY completed eleven years in March 1999. The JRY was restructured with effect from April 1999 and was renamed as *Jawahar Gram Samridhi Yojana (JGSY)*. In the first ten years the JRY generated 7,373 million mandays of employment. Thus in quantitative terms the performance of the JRY was not distinctly better than that of the NREP and RLEGP. However, in two respects the JRY was superior to the NREP/RLEGP regime. First, under the JRY there was a clear change in the priorities in favour of economically productive

investments, especially which enhance the productivity of land. Second, the JRY approach involving panchayats in planning and implementation of employment schemes was superior to the bureaucratic approach followed under the NREP/RLEGP.

The objective of JGSY was creation of infrastructure and durable assets at the village level so as to increase opportunities for sustained employment to the rural poor. The wage employment under JGSY was provided normally to persons belonging to households below poverty line. There was no sectoral earmarking of resources under JGSY. However, 22.5 per cent of annual allocation had to be spent on schemes for the benefit of Scheduled Castes/Scheduled Tribes and 3 per cent of annual allocation was to be utilised for creation of barrier free infrastructure for the disabled.

Among other employment programmes most notable programmes have been the *Employment Assurance Scheme (EAS)*, the *Swarna Jayanti Shahari Rozgar Yojana (SJSRY)* and *Prime Minister's Rozgar Yojana (PMRY)*. The EAS aimed at providing 100 days of unskilled manual work on demand to two members of a rural family in the age group of 18 to 60 years in the agricultural lean season within the blocks covered under the scheme. The EAS was universalized so as to make it applicable to all the rural blocks of the country. During 1996-97 to 1999-2000 a total of 1,533.7 million man days employment was generated under the scheme. *Sampoorna Grameen Rozgar Yojana (SGRY)* was launched in September 2001 and the schemes of Jawahar Gram Samridhi Yojana (JGSY) and Employment Assurance Scheme (EAS) were fully integrated with SGRY. The objective of SGRY is to provide additional wage employment in the rural areas as also food security, alongwith the creation of durable community, social and economic infrastructure in the rural areas. The scheme is being implemented through the Panchayati Raj institutions and envisages generation of 100 crore man days of employment in a year.

The most ambitious programme for providing employment is the *National Rural Employment Guarantee Scheme (NREGS)* launched on February 2, 2006. *NREGS was initiated in 200 backward districts of the country and has the objective of providing 100 days of guaranteed unskilled wage employment to each rural household opting for it.* The scheme presently covers 330 districts. So far 16.6 million people have demanded work and 16.1 million have been provided jobs (25 per cent scheduled castes, 34 per cent scheduled tribes and 47 per cent women). The Central government has placed the cost of covering the entire country under NREGS at Rs. 20,000 crore annually. Independent researchers have pointed out many flaws in the actual implementation of the scheme. For example, a study was conducted by Delhi-based Centre for Environment and Food Security (CEFS) during May-June 2007 in 100 villages across six districts in Orissa. Officially, 799 lakh people were employed but the study found that only 25 per cent of them had actually got jobs. The employment records of the remaining 75 per cent were based on "fake master rolls, false job cards and forged official documents." On the whole, only 6 per cent workers are getting full 100 days of work or timely payment.<sup>19</sup>

### Social Security for Labour

Safety net for workers also includes provisions for social security. As far as organised labour is concerned, we have discussed the various measures in the chapter on 'Industrial Labour'. As pointed out therein, the government has enacted various social security legislations like Workmen's Compensation Act, Maternity Benefit Act, Employees' State Insurance Act, Employees' Provident Fund Act and Miscellaneous Provisions Act, Employees' Deposit Linked Insurance Scheme, etc. However, as argued in the last section of that chapter, the social security schemes being implemented in India cover only the organised sector of the industrial economy and their benefits are mostly limited to establishments employing more than 20 workers. Even in respect to the needs of these beneficiaries, the benefits available under the different social security schemes are woefully inadequate.

The most serious lacuna in the social security network in India is the almost total absence of social security measures for workers in the unorganised sector of the economy (and these workers constitute as much as 92 per cent of total work force). Only recently, some schemes have been launched to give some sort of social security to these people. For example, Krishi Shramik Samajik Suraksha Yojana was launched in July 2001 to provide social security to agricultural workers. Janshree Bima Yojana was launched in August 2000 to provide life insurance protection to the rural and urban poor including unorganised workers who are below and marginally above the poverty line. The government launched a social security scheme for workers drawing wage of not more than Rs. 6,500 per month in the unorganised sector on January 23, 2004, on a pilot basis in 50 districts of the country. However, all these schemes are yet to make any impact. In any case, they are totally insufficient to serve the needs of the large number of workers in the unorganised sector. Since, as noted earlier in this

chapter, a large number of job opportunities in the coming years are likely to emerge in the unorganised sector, it is imperative on the part of the government to introduce effective social security measures in the unorganised sector. The latest initiative taken by the Government of India in this field in the introduction of Aam Adami Bima Yojana which aims at providing social security to 1.45 crore landless families in rural areas. Under it, government will give head of each family Rs. 30,000 as compensation in case of natural death, Rs. 75,000 for accidental death and Rs. 37,500 for partial permanent disability.

### ■■■■ CONCLUSION ■■■■

As has been clearly brought out in this chapter, economic reforms have had an adverse effect on the labour market by engendering job and income insecurities. Therefore, it is necessary to devise an appropriate mix of labour and social policies. As far as labour policy is concerned, it is necessary to undertake steps in the following directions: (1) reskilling, rehabilitation and redeployment of adversely affected workers (*i.e.* workers who have lost their jobs in the process of corporate restructuring and privatisation); (2) identifying labour-intensive sectors and removing impediments in their growth; (3) improving productivity in agriculture as agriculture is bound to remain the largest sector from the employment perspective for a long time to come; (4) improving and strengthening rural infrastructure (transport, power and social infrastructure) as it has a substantial employment providing capacity; and (5) linking rural businesses (food-processing industries, cold chains, wholesale trade, transport, animal husbandry etc. and their support services) with the wider world. As far as social policies are concerned, it is necessary to widen the net of social security measures to include all segments of labour (particularly unorganised labour) in it.

### ■■■■ NOTES ■■■■

1. V.R. Panchamukhi, Nagesh Kumar and Ram Upendra Das, "Economic Reforms and Implications for Labour Markets", in Ramgopal Agarwala, Nagesh Kumar and Michelle Riboud (ed.), *Reforms, Labour Markets and Social Security in India* (New Delhi, 2004), pp. 139-143.
2. *Ibid.*, p. 140.
3. *Ibid.*, p. 141.
4. *Ibid.*, p. 142.
5. During the period 1983-1993, 500 largest firms of the world shed over 4,00,000 workers yearly, notwithstanding the upsurge of their combined revenue. Such massive labour liquidation was resorted to not because profits were threatened but because of the rapacious imperatives of making bigger and bigger profits for the shareholders. See Frederic F. Clairmont and John H. Cavanagh, "World's Top 200 Mega Corporations," *Economic and Political Weekly*, February 5, 1994, p. 284. This example shows that the danger of labour displacement as a consequence of MNCs' increasing penetration in the Indian economy is not hypothetical but very real.
6. Government of India, Planning Commission, *Tenth Five Year Plan 2002-07* (New Delhi, 2003), Volume I, Annexure 5.6, p.163.
7. T.S. Papola, "The Question of Unemployment" in Bimal Jalan (ed.), *The Indian Economy: Problems and Prospects* (New Delhi, edition 2004), pp. 354-5.
8. Chandrasekhar and Ghosh note that during the decade of 1980s when there was a very large increase in expenditure on the rural sector by State and Central Governments, nearly 60 per cent of all new government jobs created accrued to rural areas. Over the decade 1977-78 to 1987-88, government accounted for nearly four-fifths of regular job creation in rural areas and by 1987-88, nearly two-thirds of the regular non-agricultural employees in rural areas were employed by the government. C. P. Chandrasekhar and Jayati Ghosh, *The Market that Failed — A Decade of Neoliberal Economic Reforms in India* (New Delhi, 2002), pp. 142-3.
9. Tata Services Ltd., *Statistical Outline of India, 2006-07* (Mumbai, 2007), Table 67, p. 66.
10. *Business Standard*, August 18-19, 2001, p. 1.
11. Roach's study quoted by Abheek Barua "India's Jobless Recovery" *Business Standard*, November 12, 2004, p.9.
12. *Business Standard*, in August 25, 2001, p.1.
13. Quoted in Panchamukhi, Kumar and Das, *op. cit.*, p. 145.
14. Alakh N. Sharma, "Employment Generation Policy and Social Safety Nets in India" in Ramgopal Agarwala, Nagesh Kumar and Michelle Riboud (ed.) *Reforms, Labour Markets and Social Security in India*, *op. cit.*, p. 255.
15. Avinash Celestine, "Two Faces of Indian Labour", *Businessworld*, March 1, 2004, p. 23.
16. Panchamukhi, Kumar and Das, *op. cit.*, pp. 149-150.
17. Abhik Ghosh, "The Catch in Safety Net," *The Economic Times*, December 4, 1995, p.4.
18. Alakh N. Sharma, *op. cit.*, p.259.
19. *The Hindustan Times*, October 17, 2007, p. 13.

# WORKERS' PARTICIPATION IN MANAGEMENT

## Objectives of Workers' Participation In Management

### Forms of Workers' Participation

#### Workers' Participation In Management In India

• Works' Committees • Joint Management Councils • Schemes for Workers' Participation in Industry at Shop Floor and Plant Level • Committee on Workers' Participation in Management and Equity • Scheme for Workers' Participation in Public Sector Undertakings, 1983 • The Participation of Workers in Management Bill, 1990

#### A Critical Evaluation

During the period of industrial revolution in the now developed countries, the relationship between employer and employee was almost like that of master and slave. The capitalist ruthlessly exploited the worker to generate as much profit as possible from the enterprise. The worker became a commodity—he lost his identity and became a cog in the machine. However, with the spread of the social reform movement, the workers gradually became aware of their sordid state and their contribution to the industrial output and economic development of the country. They started organising themselves into trade unions and thus discovered the might of collective bargaining. With the change of times, the worker now feels that he is an integral part of the enterprise and must have a say in the decision-making processes, i.e., he must have a voice in determining the rules and regulations in the enterprise in which he is working. The managements have also come to realise the importance of cooperation as *decisions taken after due deliberations with labour are likely to be implemented willingly and wholeheartedly leading, in turn, to more industrial output on the one hand, and a better congenial industrial environment on the other hand.* In this chapter we propose to address the following questions:

- What are the objectives of workers' participation in management ?
- What are the forms of workers' participation ?
- What steps have been taken in India to increase workers' participation in management ?

## ■■■■ OBJECTIVES OF WORKERS' PARTICIPATION IN MANAGEMENT ■■■■

The main objectives of workers' participation in management are as follows:

1. An atmosphere of industrial peace is necessary to ensure increases in industrial production and productivity and this is best achieved when workers are allowed to participate in the management of the enterprise in which they are employed.
2. Cooperation between employers and workers is expected to lead to better utilisation of human resources and improve the morale of the workers.
3. Participation of workers in the management will bestow due dignity to labour, help them in improving their personality and fulfil their urge for self-expression, and also increase their knowledge and expertise in managing the affairs of the company.

4. There is no better way to safeguard the interests of workers than by making them co-partners in the running of the enterprise. This will also promote industrial democracy which is a *sine quo non* of economic freedom.
5. Workers' participation in management is likely to regulate the self centered actions of the capitalists and put an end to the exploitation of workers.
6. Business can fulfil its responsibility towards the employees, the community and the society at large in a better way as workers' participation in management is likely to increase the management's 'sensitivity' to the larger issues concerning social welfare.

According to the Second Five Year Plan, *increased association of labour with management helps in "(a) promoting increased productivity for the general benefit of the enterprise, the employees and the community, (b) giving employees a better understanding of their role in the working of industry and of the process of production, and (c) satisfying the workers' urge for self expression, thus leading to industrial peace, better relations and increased cooperation."*<sup>1</sup>

### ■■■■ FORMS OF WORKERS' PARTICIPATION ■■■■

Workers' participation in management can assume various forms depending upon the subjects or areas in which the participation is sought, labour-management relations, the strength of the labour unions and their power to influence the decision making processes, the general socio-political environment in which production is carried out, etc. Some managerial decisions are taken at the top level particularly the decisions concerning the type of products to be manufactured, the markets to be tapped, etc.; while some other decisions are taken at the middle and lower levels particularly those relating to the personnel matters and matters concerning the social welfare of the workers. Therefore, workers' participation will have to be at different levels and in different forms. Through the power to send their representatives to the Board of Directors, the workers may be in a position to influence the policy decisions at the top level. They can participate at the middle level through their representatives on the supervisory boards. At the lower level, they can be entrusted with the task of working out their job-schedules, hours of work, social welfare schemes etc. According to Tanic, "Ranging from a situation where workers are cooperated with only in the physical and technical sense to a situation workers participate totally in organising the social system of production, workers' participation in management can take any form. Joint Management is the most elementary form of workers' participation in management, workers' government being the ultimate that it can achieve."<sup>2</sup>

The main forms of workers' participation in management are as follows:

**Informative Participation.** In this form, the management shares corporate information with the workers. Information sharing helps the workers in planning their actions.

**Advisory and Constructive Participation.** Here the management takes the advice of workers in formulating plans for the company. The advice may relate to work, planning, production, sales, etc.

**Collective Bargaining.** This is the most potent instrument in the hands of trade unions. Matters relating to workers' income and welfare like the settlement of wages, bonus, hours of work, working conditions, health and medical facilities are generally settled through the method of collective bargaining.

**Works Councils, Works Committees, Joint Management Councils, etc.** In most of the countries, workers' participation in management has been ensured through the setting up of the Works Councils, Works Committees, Joint Consultative Bodies, etc. In some countries like Austria, Belgium, Finland, France, Germany, Netherlands, Luxembourg, Spain, Pakistan, Sri Lanka etc., these bodies have been set up by legislation. In India, the Industrial Disputes Act, 1947, provided for the setting up of a Works Committee consisting of representatives of management and employees in every undertaking employing 100 or more employees. In some countries like Denmark, Norway and Sweden, Works Councils, Works Committees, etc., have been established as a result of agreements between the organisations of workers and the representatives of managements.

In most countries, these bodies have a joint composition, that is, they include representatives of both the management and the workers, quite often on an equal basis. In some countries like Germany and Austria, they are composed only of representatives of the workers. The representatives of the workers on the Committees are selected either by the employees as a whole or by workers who are members of the trade union. In any case, it has been observed that the great majority of the members of works councils are trade unionists.<sup>3</sup> The Works Committees confer on various matters affecting the working of the enterprise, personnel issues and working conditions, and management of welfare services for the workers employed in the organisation.

**Workers' Representatives in Management Organs.** In a large number of countries, workers' representatives have been included in the management organs of enterprises (particularly public sector enterprises, national railways, airways and public services like posts and telegraphs, gas, water and electricity etc.) These workers' representatives may be directly nominated by the trade unions or by the government, or elected by the employees. According to Mustafa and Sharma, in the private sector, the system which has pushed workers' participation to the furthest degree is that of co-determination applied in the Federal Republic of Germany since the beginning of the 1950s. In companies which adopted this principle of co-determination, equal representation was granted to workers on the supervisory boards. Thus, the boards generally included five workers' representatives, five representatives of the shareholders, and an eleventh member nominated by mutual agreement.<sup>4</sup> To ensure workers' representatives in management organs, many other western European countries also adopted necessary legislations. However, in most cases, workers were given only a minority representation as compared to that of shareholders.

**Self-Management.** The most far reaching type of workers' participation in management is the one in which workers are allowed the right to self-management in decisions concerning them. Probably the best known example in this field is the system of self-management practised with considerable success in erstwhile Yugoslavia (i.e. the Yugoslavia under the socialist system). Under the Yugoslavian system, the workforce of the undertaking exercised the principal functions of the management through the self-management organs, the organisation and powers of which were established since the sixties by the statute or internal regulations of the undertaking, namely, the workers' assembly and the workers' council. The workers' council enjoyed wide powers in the field of management in general; for example, it adopted the internal regulations, development plans and other programmes of the undertaking, supervised their implementation, decided on investments and approved the balance sheets. After every four years, it elected the director of the undertaking and set up a management board, a supervisory committee, and a whole series of specialised committees to deal with matters pertaining to specific fields.<sup>5</sup>

## ■■■■ WORKERS' PARTICIPATION IN MANAGEMENT IN INDIA ■■■■

### Works' Committees

The Industrial Disputes Act, 1947 took the first step in Independent India toward workers' participation in management when it provided for the setting of a Working Committee, consisting of representatives of management and employees in every undertaking employing 100 or more workers "*to promote measures for securing and preserving amity and good relations between the employer and the workmen*". The usefulness of Works Committees as a machinery for joint consultation was stressed by the successive five year plans. Because of the legal requirement and the encouragement given by the government, a number of Works Committees were set up by different industries. However, the pace of progress was slow, halting and uneven in different parts of the country. Many criticisms were also levied against these Works Committees as their working was often found to be ineffective. Their ineffectiveness was due to the reasons that they were statutory and the persons on these Committees did not evince much interest in their functioning.

### Joint Management Councils

Joint Management Councils (JMCs) owe their origins to the observations made in the Industrial Policy Resolution of 1956 and later incorporated in the labour policy statement of the Second Five Year Plan. Following the statement of the Second Plan, a scheme for setting up JMCs was pushed through in the 15th session of the Indian Labour Conference held in 1957. In 1958, a scheme of JMCs was envisaged and such councils were set up in 23 units. The Third Plan proposed the progressive extension of JMCs to new industries and units so that, in the course of a few years, they could become a normal feature of the industrial system. *The objectives of the JMCs were as follows: (i) to provide for mutual consultations between employers and workers over many important issues which affect industrial relations; (ii) to promote cordial relations between management and workers; (iii) to promote labour welfare and provide better facilities to the workers; (iv) to help the workers in understanding the responsibilities of management; and (v) to create an environment conducive to increases in industrial productivity.*

### Scheme for Workers' Participation in Industry at Shop Floor and Plant Level

The 20 point economic programme of the government adopted during the period of Emergency in 1975

introduced a scheme for workers' participation in industries particularly at the top floor level and in production programmes. The scheme was initially made applicable to those industries which had 500 or more workers on their rolls. The scheme provided for shop councils at the shop/departmental levels and Joint Councils at the enterprise level.

**Shop Councils.** The scheme laid down that in every industrial unit employing 500 or more workers, the employer would constitute a shop council for each department or shop, or one council for more than one department or shop, considering the number of workman employed in different departments or shops. Each council was to consist of an equal number of representatives of employer and workers. The employer's representatives were to be nominated by the management and had to be from amongst the persons of the unit concerned. Similarly, all the representatives of workmen had to be from amongst the workers actually engaged in the department or the shop concerned. It was provided that the number of members of each council may be determined by the employer in consultation with the recognised unit but should not, in general, exceed twelve. A shop council, once formed, was to function for a period of two years and was to meet at least once in a month.

The main functions of the shop councils were defined as under: (i) to assist management in achieving monthly/yearly target; (ii) to help in improving production, productivity and efficiency and eliminate wastage; (iii) to identify areas of low productivity and take necessary corrective steps; (iv) to study absenteeism and recommend steps to reduce it; (v) to assist in maintaining general discipline in the shop/department; (vi) to adopt welfare and health measures, improve physical conditions of working and undertake safety measures; and (vii) to ensure adequate two-way communication between management and labour.

**Joint Council.** The scheme provided for the setting up of a Joint Council in every industrial unit employing 500 or more workers. The main features of the Joint Council were to be as follows: (i) only such persons who are actually engaged in the unit were to be members of the Joint Council; (ii) the Council was to function for a period of two years; (iii) the chief executive of the unit was to be the chairman of the Joint Council; (iv) the Vice-Chairman of the Council was to be nominated by workers-members of the Council; (v) the Joint Council was to appoint one of the members of the council as its Secretary; (vi) the term of the Council was to be two years and it was laid down that it would meet at least once in a quarter; and (vii) every decision of the Joint Council was to be on the basis of consensus and had to be implemented within one month unless otherwise stated in the decision itself.

The Joint Council was to deal with matters relating to (i) optimum production, productivity and efficiency; (ii) functions of a shop council which have a bearing on another shop or the unit as a whole; (iii) matters emanating from shop councils which remain unresolved; (iv) matters concerning the unit or the plant as a whole (for instance, tasks assigned to a shop council at the shop/department levels but relevant to the unit as a whole); (v) the development of skills of workmen and adequate facilities for training; (vi) the preparation of schedules of working hours and of holidays; (vii) awarding of rewards for valuable and creative suggestions received from workers; (viii) optimum use of raw materials; (ix) quality of finished products; and (x) general health, welfare and safety measures.

In the light of some experience gained in the working of the scheme of 1975, the government introduced another scheme in January 1977 for workers' participation in management in commercial and service organisations having large scale public dealings and employing at least 100 persons. The scheme was made applicable to organisations like hospitals, posts and telegraph offices, railway stations/booking offices, road transport corporations, State electricity boards, banks, insurance, educational institutions etc.

### **Committee on Workers' Participation in Management and Equity**

The working of the 1975 scheme was discussed at a Tripartite Labour Conference held on 6-7 May, 1977. On the recommendations of the conference, a Committee on Workers' Participation in Management and Equity was appointed under the chairmanship of the Union Minister of Labour, Ravinder Verma, in December 1977. The Committee consisted of 21 members representing central organisations of trade unions and employers, some of the States and professional institutes of management. The Committee was asked to deliberate and make recommendations on the following issues: (1) recognising the need for the participation of workers at different levels of management in industrial establishments/undertakings, to consider and recommend an outline of a comprehensive scheme for such participation keeping in view the interests of the economy, efficient management and workers; (2) whether there should be a statutory scheme for participation in management which should replace the existing statutory Works Committee and any other similar committee functioning in a plant/unit; (3)

whether the proposed scheme should cover, in addition to management at shop and plant levels, the higher levels of management also, for example, the board of directors; (4) to what extent, and in what manner, can the concept of trusteeship in industry be given a practical shape in the proposed scheme of workers' participation; and (5) whether and to what extent and in what manner participation by workers in equity holdings of industrial establishments/undertakings should be encouraged or provided for.

The Committee submitted its Report in March 1981. The majority of the members favoured the adoption of a three-tier system of participation, namely, at the corporate level, plant level and shop-floor level. The Committee laid down the detailed functions of the councils at the shop level, plant level and the corporate/board level. The participation envisaged at these levels included full sharing of information to enable joint decision-making and, in certain areas, joint administration. It also envisaged collective formation of policies and norms. A monitoring agency at the Centre and State levels was also suggested to monitor the implementation of the scheme of workers' participation.

### **Scheme for Workers' Participation in Public Sector Undertakings, 1983**

On the basis of the recommendations of the above-mentioned Committee on Workers' Participation in Management and Equity, the government introduced a new and comprehensive scheme for workers' participation in the management of Central public sector enterprises vide resolution dated December 30, 1983. The scheme was introduced in all Central public sector enterprises except those which are given specific exemption and the departmental undertakings. The State governments/Union territories were requested to introduce the scheme in their own public sector enterprises and the private sector was also encouraged to implement the scheme. As far as the Central public sector undertakings are concerned, the scheme was to be operated both, at the shop-floor and the plant levels. The list of functions of these participative forums was made more elaborate and comprehensive in the new scheme. For example, it was stated that at the shop-floor level, the participative forum will look into a wide range of functions like production and storage facilities in the shop, material economy, operational problems, wastage controls, safety problems, monthly targets and production schedules, cost reduction measures, welfare measures related to the shop etc. *The functions of the participative forum at the plant level were divided into the following categories: (i) operational areas, (ii) economic and financial areas, (iii) personnel matters, (iv) welfare areas, and (v) environmental areas.* Operational areas included functions relating to enhancing production and productivity levels, review of monthly targets and schedules, materials supply and its shortfall, review of working of the shop level bodies etc. Economic and financial areas included functions relating to profit and loss statements and balance sheets, review of operating finances, labour and management costs etc. Personnel matters included administration of social security schemes, special problems of women workers, initiation and supervision of workers' training programmes etc. Welfare measures included implementation of welfare schemes, medical facilities, safety measures, housing, sports and games, canteen facilities etc. Environmental areas included extension activities and community development projects, and pollution control.

### **The Participation of Workers' in Management Bill, 1990**

The Government of India introduced a Bill 'The Participation of Workers in Management Bill, 1990' in the Parliament in 1990 *"to make provisions for the participation of workers in the management of undertakings, establishments or other organisations engaged in any industry and to provide for matters connected therewith or incidental thereto"*. The Bill noted that while the Constitution was amended in 1976 and Article 43A was inserted in Directive Principles of State Policy stating that "the State shall take steps by suitable legislation, or in any other way to ensure the participation of workers in the management of the undertakings, establishments or other organisations engaged in any industry", most of the schemes pertaining to programmes of workers in management have been non-statutory with the result that they have been unable to provide an effective framework for a meaningful participation of workers in management at all levels. The Bill, therefore, sought a statutory status for the participation schemes. It intended to :

(i) provide for specific and meaningful participation of workers in management at shop floor level, establishment level and board of management level in industrial establishments;

(ii) provide for formulation of one or more schemes to specify detailed criteria, such as, the manner of representation of workmen and other workers on the Board of Management, Shop Floor Council and Establishment Council, procedure to be followed in the discharge of the functions by a council etc. ;

(iii) provide for the principle of secret ballot for determining the representation of workmen on the shop floor and management level councils and of workmen and other workers on the board of management;



(iv) provide for rules to specify the power which an Inspector may exercise, the number of members of the Monitoring Committee and the manner in which they will be chosen etc.

The Bill provided for the setting up of Shop Floor Council at the shop floor level and Establishment Council at the establishment level. These councils were to consist of equal number of representatives of the employer and the workmen. The functions of the Shop Floor councils and the Establishment Councils were approximately the same as considered above in the case of the 1983 comprehensive scheme for workers' participation in public sector undertakings. The Bill also provided for representatives of the workers on the Board of Management. Persons to represent the workmen on the Board of Management were to be elected from amongst the workmen of the industrial establishment by secret ballot, or nominated by the registered Trade Union, in accordance with the Scheme. Every representative of the workers was given all the powers and entitled to discharge all the functions of a member of the Board of Management and was entitled to vote. The Board of Management had powers to review the functioning of the Shop Floor Councils and the Establishment Council.

The Bill also provided for the setting up of a Monitoring Committee (constituted of equal number of members representing the appropriate government, the workers and the employers) to review and advise the government upon matters arising out of the administration of the provisions of the Bill, any Scheme or any rules made thereunder.

However, the Bill could not get the necessary clearance from the Parliament and did not become an Act.

### ■■■■ A CRITICAL EVALUATION ■■■■

The schemes pertaining to workers' participation in management in India have not able to accomplish much. Even in the case of Central public sector undertakings, only 91 enterprises have introduced the scheme on employees' participation in management at shop floor/plant level. There has been no board level participation from the workers' representatives.<sup>6</sup>

The Works Committees and the Joint Management Councils also failed in their objectives. In their evidence before the National Commission on Labour, the State Governments pointed out that the Works Committee had failed to deliver the goods as the representatives of these Committees did not evince much interest in their functioning, there was vagueness regarding their exact scope and functions, the nature of recommendations was advisory in character, inter-union rivalries did not allow a common workers' perspective to emerge, the attitude of employers was unhelpful, etc. The National Commission on Labour also found that there was not much support for Joint Management Councils in their existing forms. These Councils had proved to be ineffective and their functioning was unsatisfactory. In those enterprises where Works Committees were functional, JMCs were found to be superfluous. Even when JMCs were formed, the managements did not take their opinions seriously while actually evolving policies. Even in matters concerning the welfare of workers, the role of the Councils was merely consultative and the final decisions rested with the management. Matters relating to personnel, economic and technological aspects were rarely discussed. Because of this 'peripheral role', the concerned parties lost interest in these joint bodies. Consequently, more emphasis is placed in India on collective bargaining than on joint consultative committees.<sup>7</sup>

### ■■■■ NOTES ■■■■

1. Government of India, *Second Five Year Plan* (Delhi, 1956), p. 577.
2. Quoted in M. Mustafa and Omkar Sharma, *Workers' Participation in Management: Concept and Practice* (New Delhi, 1999), p. 22.
3. *Ibid.*, p. 37.
4. *Ibid.*, pp. 30-31.
5. *Ibid.*, pp. 26-27.
6. *Ibid.*, p. 89.
7. *Ibid.*, p. 90.



## UNIT 8

# Financial Environment of Business

- 48. Indian Money Market
- 49. Capital Market in India
- 50. Stock Market and its Regulation
- 51. Commercial Banking in India
- 52. Financial Institutions

*"As the organisation of money market improves, the risk of the predominance of speculation does, however, increase... speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of a casino, the job is likely to be ill-done."*

*— John Maynard Keynes*

# INDIAN MONEY MARKET

## *The Indian Money Market*

### *Unorganised Sector of the Indian Money Market*

### *Organised Sector of the Indian Money Market*

- The Call Money Market • The Treasury Bill Market • The Repo Market • The Commercial Bill Market • The Certificate of Deposit Market • Commercial Paper • Money Market Mutual Funds

### *Characteristics of the Indian Money Market*

### *Underdevelopment of the Money Market in India and Measures to Strengthen it*

- Reform Measures • Outlook for the Future

*Money market refers to a mechanism whereby on the one hand borrowers manage to obtain short-term loanable funds and on the other, lenders succeed in getting creditworthy borrowers for their money.* In any money market, commercial banks are the most important lenders. These banks are, however, not merely the lenders of money, they also create credit. The central bank's role is important as the controller of credit. The money market as it existed in India during the pre-Independence period was far more undeveloped than what it is today. Now the Indian money market in spite of all its limitations and defects is perhaps one of the most organised money markets in a Third World country.

In this chapter, we propose to discuss the following issues:

- The nature of the unorganised sector of the Indian money market.
- Organised sector of the Indian money market and its various constituents.
- Characteristics of Indian money market.
- Measures introduced to strengthen the money market in India.

## ■■■■ THE INDIAN MONEY MARKET ■■■■

*The Indian money market is not an integrated unit. It is broadly divided into two parts, viz., the unorganized and the organized.* There is compartmentalisation between the two markets and as such the rates of interest differ in the unorganized sector from those in the organized sector. The unorganized sector of the money market comprises the indigenous bankers and the moneylenders. This, in fact, is not a homogenous sector. The organized sector, on the other hand, is fairly integrated. Both nationalised and the private sector commercial banks constitute the core of the organised sector. The foreign banks, co-operative banks, Reserve Bank of India, Discount and Finance House of India, development finance institutions like IDBI and IFCI and investment finance companies like the LIC, GIC and UTI and Mutual Funds are the other institutions which operate in the organised sector of the Indian market. *The Reserve Bank of India is the apex organisation in the Indian money market.* Since it is the leader and controller of the money market, it has great responsibility in respect of smooth functioning of the financial system. In April 1988, the Reserve Bank of India set up the Discount and Finance House of India to perform the function of stabilising the money market.

### ■■■■ UNORGANIZED SECTOR OF THE INDIAN MONEY MARKET ■■■■

Although some indigenous bankers and moneylenders exist even in big cities, the fact is that their banking activities, or to be more specific, lending activities are mostly confined to small towns and villages where modern banking facilities are still inadequate. Farmers, artisans and other small scale producers and traders who do not have access to modern banks, borrow from them. Lendings of the moneylenders are rather small, but some indigenous bankers do a considerable amount of business. They pursue banking business on traditional lines and combine it with other businesses.

**1. Unregulated non-bank financial intermediaries.** In India, there are several types of unregulated non-bank financial intermediaries. Among these the most prominent are (i) *finance companies*, (ii) *chit funds* and (iii) *nidhis*. Finance companies are found in all parts of the country. The exact number of finance companies is not known. Finance companies generally give loans to retailers, wholesale traders, artisans and other self-employed persons. Since finance companies charge high rates of interest varying from 36 to 48 per cent, normally corporate firms do not borrow from these companies. The chit funds are savings institutions. They are of various types lacking any standardised form. A chit fund has regular members who make periodical subscriptions to the fund. The periodic collection is given to some member of the chit fund selected on the basis of previously agreed criterion. The chit fund business is now done in almost all the States but Kerala and Tamil Nadu account for the major part of total chit fund business. Estimates of deposits received by the chit fund companies and their annual turnover are not available. The RBI has absolutely no control over the lending activities of the chit funds. The *nidhis* operate particularly in South India. In their character they are like some kind of mutual benefit funds as their dealings are restricted only to the members. Since the *nidhis* operate in the unregulated credit market, there is hardly any information available about the amount of lending business done by them.

**2. Indigenous bankers.** Indigenous bankers are individuals or private firms which receive deposits and give loans and thereby operate as banks. Since their activities are not regulated, they belong to the unorganised segment of the money market. Indigenous bankers do not constitute a homogenous group. Broadly they may be classified under four main sub-groups : Gujarati Shroffs, Multani or Shikarpuri Shroffs, Chettiars and Marwari Kayas. The Gujarati Shroffs operate in Mumbai, Kolkata, and the industrial and trading cities of Gujarat. The Marwari Shroffs are active in Kolkata, Mumbai, tea-gardens of Assam and other parts of North-East India. The Multani or Shikarpuri Shroffs are to be found mainly in Mumbai and Chennai and the Chettiars are concentrated in the South. Of the four main such groups of the indigenous bankers, the Gujarati indigenous bankers are the most important in terms of the volume of business. Over the past three decades the indigenous bankers have faced stiff competition from the commercial and cooperative banks, yet they have survived.

**3. Moneylenders.** Moneylenders do not constitute one homogeneous category. Broadly they are of three types: (1) professional moneylenders whose main activity is moneylending; (2) itinerant moneylenders, like Pathans and Kabulis, and (3) non-professional moneylenders whose main source of income is not money lending. The methods of operation of the moneylenders are not uniform. Their activities are generally localised.

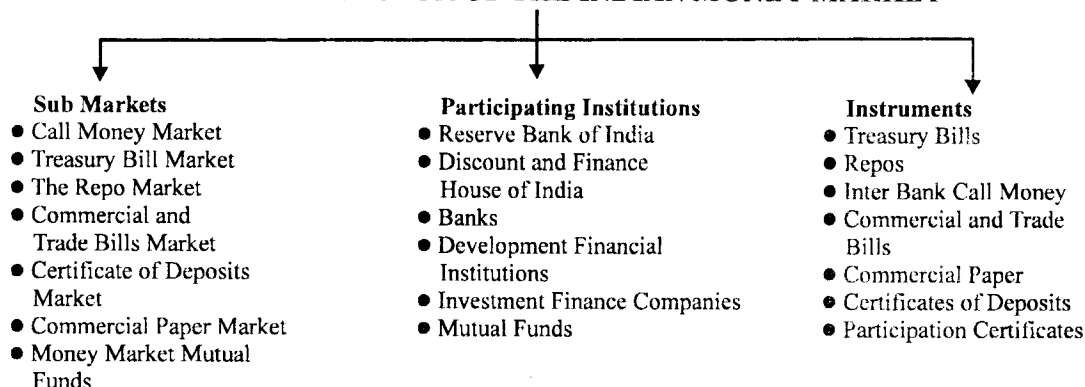
### ■■■■ ORGANIZED SECTOR OF THE INDIAN MONEY MARKET ■■■■

The modern sector of the Indian money market is reasonably well organized and integrated. Leaving aside some highly developed financial centres, the organized sector of the Indian money market is far more organized and developed than the money markets in most of the countries. *The organized sector of the Indian money market comprises the Reserve Bank of India, commercial banks, foreign banks, cooperative banks, finance corporations, Mutual Funds and the Discount and Finance House of India Limited (DFHI).*

Mumbai, Kolkata, Delhi, Chennai, Ahmedabad and Bangalore are the principal centres of the organized sector of the Indian money market, of which Mumbai is the most prominent. The Mumbai money market has now become synonymous with the Indian money market. At present the Mumbai money market occupies the same position in India as the London money market in England and the New York money market in the USA. The presence of the head offices of the RBI and various commercial banks, the leading stock exchange, well organized market of the government securities, the billion exchange and the cotton exchange have made Mumbai the most prominent financial centre of the country.

No doubt the organised sector of the Indian money market is fairly developed and organised, yet it is not comparable to the New York or the London money market. Broadly the principal constituents of the Indian money market are: (i) The Call Money Market, (ii) The Treasury Bill Market, (iii) The Repo Market, (iv) The

**BOX 48.1**  
**ORGANIZED SECTOR OF THE INDIAN MONEY MARKET**



Commercial Bill Market, (v) The Certificate of Deposits Market, (vi) The Commercial Paper Market and (vii) Money Market Mutual Funds. Box 48.1 shows the structure of the organised sector of the Indian money market.

### The Call Money Market

*The call money market consists of overnight and money at short notice for periods upto 14 days. It is meant to balance the short-term needs of banks.* The call money market exists in almost all developed money markets. It is generally the most sensitive part of the financial system. Any change in flow of funds and the demand for them is clearly reflected in it. The response is generally quick. In India, the call money market is centred at Mumbai, Kolkata and Chennai. Among these, the market at Mumbai is the most important. During the 1980s the call money rate was an administered one. Its ceiling at 10 per cent was fixed by the Indian Banks Association. This was the time when there were a few large lenders and a large number of borrowers in the call money market. Since in this period there were not many participants who alternated as both lenders and borrowers, the call money market failed to develop adequately. The UTI and the LIC were large lenders. They were not allowed to operate as borrowers. These investment institutions had a sizeable short-term float which they could profitably deploy in the call money market. The commercial banks were usually the borrowers. Their needs for short-term funds often coincided. Among the banks the State Bank of India was sometimes on the lender's side of the market on account of its strong liquidity position.

On the recommendations of the Vaghul Committee the Discount and Finance House of India (DFHI) was set up in April 1988. In July 1988 the DFHI was allowed to operate both as lender and borrower in the call money market. The operations of the DFHI were exempted from the ceiling rate set by the Indian Banks Association. These measures helped in the development of the call money market as they corrected imbalances in the supply and demand for funds in the market. With the participation of DFHI in the call money market there was a significant increase in its annual turnover.

In May 1989, the ceiling on the call money rate was withdrawn. In May 1990, the Reserve Bank of India allowed IDBI, GIC and NABARD to participate in the call money market as lenders. In October 1993, the participating development banks and the financial institutions were allowed to borrow up to an aggregate limit of Rs. 1,000 crore with individual limits to be fixed for borrowing from time to time.

Since the withdrawal of ceiling on the call money rate there have been sharp fluctuations in it due to imbalances in the demand and supply of bank reserves. The imbalances in the demand and supply of bank reserves arose on account of several factors. The most important of these has been a branching up of the banks' needs for short-term funds in order to meet cash reserve ratio (CRR) requirements. Another contributing factor has been the unsound policy of some large banks to invest in medium and long-term assets by borrowing from the call money market. Finally, the occasional withdrawal of liquidity from the banking system by the government led to imbalances in the demand and supply of bank reserves.

According to Kunal Sen and Rajendra R. Vaidya, instability in the call money rates in the post-1990 period notwithstanding, "with the deregulation of the interest rate and the widening of the market through the

participation of more non-bank financial institutions as both lenders and borrowers, the call money market has been playing an increasingly important role in equilibrating the banking system's demand and the supply of the short-term funds. Clearly, with the growth in the size of the call money market (as evident by the increase in DFHI's annual turnover), the need for commercial banks to hold on to excess reserves to meet any unanticipated deposit withdrawals by bank customers has been greatly reduced thereby lowering bank intermediation costs. The setting up of DFHI in 1988 and its emergence as 'a major force in the call money market' have also contributed to the development of the market."<sup>1</sup>

The turnover and interest rates in the call money market generally reflect varying liquidity conditions. The average call rate (which is the average of daily weighted call money borrowing rates) was 5.60 per cent during 2005-06 and 7.22 per cent during 2006-07. The average daily turnover in the call money market was Rs. 17,979 crore in 2005-06 which rose to Rs. 21,725 crore in 2006-07.

### The Treasury Bill Market

*The market which deals in treasury bills is known as the treasury bill market. In India, treasury bills are short-term liability of the Central government.* Theoretically treasury bills should be issued for meeting temporary deficits which a government faces due to its excess of expenditure over revenue at some point of time. However, in India till recently they were a permanent source of funds for the Central government, as every year more new bills were issued than those retired. Further, every year a part of treasury bills held by the Reserve Bank of India was converted into long-term bonds.

*The treasury bill market in India is very much undeveloped. Except the RBI, there are no major holders of treasury bills.* In fact, even the RBI is a passive or captive holder of these bills which implies that it is under an obligation to purchase all the treasury bills which are being offered to it by the government. It is also required to rediscount whatever treasury bills are presented to it by banks and others for this purpose. This has resulted in the monetization of public debt and has become a major source of inflationary expansion of money supply.<sup>2</sup> At present the RBI holds most of the outstanding treasury bills. Other holders, such as commercial banks, State governments and semi-government bodies do not hold them in large quantities. Non-bank financial intermediaries, such as the LIC and the UTI and corporate and non-corporate firms do not hold treasury bills. In contrast, in the U.S.A. and the U.K., treasury bills are the most important money market instrument, and as a result the open market operations of the central bank in these countries are quite effective. Since April 1, 1997, however, wide-ranging changes have been made in respect of treasury bills so as to make this segment more vibrant and responsive to policy changes. Effective from April 1, 1997, *ad hoc* and on-tap treasury bills have been replaced by Ways and Means Advances for financing the Central government's temporary deficits. It is hoped that this measure would prevent monetisation of public debt and inflationary expansion of money supply.

At present the following types of treasury bills are in use:

**14-Day Intermediate Treasury Bills.** With the discontinuance of tap treasury bills, the Central government had introduced the scheme of 14-day treasury bills to provide the State governments, foreign central banks and specified bodies with an alternative arrangement to invest their surplus funds. These treasury bills were to be sold only to the State governments, foreign central banks and other specified bodies with whom the RBI has an agreement for investing their temporary surplus funds. Auction of these treasury bills was discontinued from May 14, 2001.

**14-Day Auction Treasury Bills.** The Reserve Bank of India introduced 14-day auction treasury bills on a weekly basis with effect from June 6, 1997. The dual purpose of introducing these treasury bills was to facilitate the cash management requirements of various segments of the economy and to help in forming a complete yield curve for aiding in the pricing of debt instruments. The 14-day auction treasury bills did not devolve on the Reserve Bank unlike the 91-day treasury bills. Auction of these treasury bills was discontinued from May 14, 2001.

**91-Day Treasury Bills.** Earlier there were two types of 91-day treasury bills—ordinary and *ad hoc*. With effect from April 1, 1997 *ad hoc* treasury bills were discontinued. On this day 91-day *ad hoc* treasury bills amounting to Rs. 38,130 crore were converted into special securities without any specific maturity. The interest on these securities was fixed at 4.6 per cent per annum.

In 1992-93 a scheme for the issue of 91-day treasury bills with the RBI of India participation was introduced. The cut off yields on these treasury bills were higher than the fixed discount rate of 4.6 per cent per annum on 91-day treasury bills sold on tap.



**182-Day Treasury Bills.** 182-day treasury bills were reintroduced with effect from May 26, 1999. As per the calendar, notified amount for 182-day treasury bills remained constant at Rs. 100 at the fortnightly auctions held on Wednesdays preceding non-reporting Fridays. Auction of these treasury bills was discontinued from May 14, 2001.

**364-Day Treasury Bills.** 364-day treasury bills were introduced in April 1992. Since then these treasury bills are auctioned on a fortnightly basis in a regular manner. These treasury bills are not rediscountable with the RBI. However, they offer short-term investment opportunities to banks and other financial institutions. Since 364-day treasury bills constitute a safe avenue for investment, the auctions of these treasury bills have evoked good response.

### The Repo Market

*Repo is a money market instrument which helps in collateralised short-term borrowing and lending through sale/purchase operations in debt instruments. Under a repo transaction, securities are sold by their holder to an investor with an agreement to repurchase them at a predetermined rate and date. Under reverse repo transaction, securities are purchased with a simultaneous commitment to resell at a predetermined rate and date.*

Initially repos were allowed in the Central government treasury bills and dated securities created by converting some of the treasury bills. In order to make the repos market an equilibrating force between the money market and the government securities market, the Reserve Bank of India generally allowed repo transactions in all government securities and treasury bills of all maturities. Lately State government securities, public sector undertakings' bonds and private corporate securities have been made eligible for repos to broaden the repo market.

Explaining the usefulness of repos *Report on Currency and Finance 1999-2000* notes that "repos help to manage liquidity conditions at the short-end of the market spectrum. Repos have been used to provide banks an avenue to park funds generated by capital inflows to provide a floor to the call money market. During time of foreign exchange volatility, repos have been used to prevent speculative activity as the funds tend to flow from the money market to the foreign exchange market."<sup>3</sup>

### The Commercial Bill Market

*The commercial bill market is the sub-market in which the trade bills or the commercial bills are handled.* The commercial bill is a bill drawn by one merchant firm on the other. Generally commercial bills arise out of domestic transactions. The legitimate purpose of a commercial bill is to reimburse the seller while the buyer delays payment. In India, the commercial bill market is highly undeveloped. The two major factors which have arrested the growth of a bill market are: (i) popularity of cash credit system in bank lending, and (ii) the unwillingness of the larger buyer to bind himself to payment discipline associated with the commercial bill. Among other factors that have prevented growth of genuine bill market are lack of uniformity in drawing bills, high stamp duty on usance or time bills and the practice of sales on credit without specified time limit.

*Commercial bills as instruments of credit are useful to both business firms and banks. In addition, since the drawees of the bill generally manage to recover the cost of goods from their resale or processing and sale during the time it matures, the bill acquires a self liquidating character. Finally, it is easier for the central bank to regulate bill finance.* Keeping in view these considerations, the Reserve Bank of India has made efforts to develop a bill market in this country and popularise the use of bills. Its two specific bill market schemes, however, had limited success. The old bill market scheme introduced in January 1952 was not correctly designed to develop a bill market. It merely provided for further accommodation to banks in addition to facilities they had already enjoyed. The scheme had, in fact, provided for obtaining loans on the security of bills rather than for their rediscount. In order to encourage use of bills the RBI offered loans at a concessional rate of interest and met half the cost of stamp duty incurred by banks on converting demand bills into usance bills. This scheme, however, failed to make any impact.

Not satisfied with the old scheme, the RBI introduced a new bill market scheme in November 1970. It has been modified from time to time. The two noteworthy features of the new scheme are: (i) the bills covered under the scheme are genuine trade bills; and (ii) the scheme provides for their rediscounting. Even this scheme which really aimed at developing a bill market in the country has not been very successful. The major obstacle to the development of bill finance in this country is the dominant cash credit system of credit delivery where the onus of cash management rests with banks. The outstanding amount of commercial bills rediscounted by the banks with various financial institutions stay often below Rs. 1,000 crore.

### The Certificate of Deposit Market

*A Certificate of Deposit (CD) is a certificate issued by a bank to depositors of funds that remain on deposit at the bank for a specified period. Thus CDs are similar to the traditional term deposits but are negotiable and tradeable in the short-term money markets.* In the mid-1980s, the short-term bank deposit rates were much lower than other comparable interest rates. The Vaghul Committee thus felt that the CD as a money market instrument could not be developed in this country until the situation remained unchanged. The Committee stressed that it was necessary for the introduction of the CD that the short-term bank deposit rates were aligned with the other interest rates. In 1988-89, the RBI, as a corrective measure, revised the rate of interest upward on term deposits of 46 to 90 days. Once this was done *in March 1989 the RBI introduced CDs with the objective of widening the range of money market instruments and providing investors greater flexibility in the deployment of their short-term surplus funds.*

The CDs could initially be issued only by scheduled commercial banks in multiples of Rs. 25 lakh (later lowered to Rs. 10 lakh) subject to the minimum size of an issue being Rs. 1 crore. Their maturity varied between three months and one year. In 1993 six financial institutions, viz., Industrial Development Bank of India, Industrial Credit and Investment Corporation of India, Industrial Finance Corporation of India, the Industrial Reconstruction Bank of India, Small Industries Development Bank of India and Export-Import Bank of India were permitted to issue CDs with a maturity period of more than one year and upto three years. CDs are issued at discount to face value and the discount rate is market determined. They are further freely transferable by endorsement and delivery. Banks pay a high interest rate on CDs. Hence, holders of CDs prefer to hold them till maturity and thus secondary activity in CDs has been non-existent. To begin with there was a lack of interest among banks in issuing fresh CDs. The stringent conditions in the money market, however, induced banks to mobilise resources on a large scale through CDs. In fact, the flexibility of return that can be offered to attract bulk deposits has made CDs the preferred route for mobilising resources for the cash-strapped banks. The outstanding amount of CDs increased from Rs. 43,568 crore at end-March 2006 (4.80 per cent of aggregate deposits of issuing banks) to Rs. 93,272 crore (4.83 per cent) by end-March 2007. As on June 22, 2007, the outstanding amount of CDs increased further to Rs. 98,337 crore.<sup>4</sup> Mutual funds are the major investors in the CDs.

### Commercial Paper

*Commercial Paper (CP) is a short-term instrument of raising funds by corporates. It is essentially a sort of unsecured promissory note sold by the issuer to the investor or via some agent like a merchant banker or a security house.* The issuance of commercial paper is not related to any underlying self-liquidating trade. Therefore, maturity of this instrument is flexible. Usually borrowers and lenders adopt a maturity of a CP to their needs. Highly rated corporates which can obtain funds at a cost lower than the cost of borrowing from banks are particularly interested in issuing CPs. Institutional investors also find CPs an attractive outlet for the short-term funds. The Vaghul Committee had strongly recommended the introduction of CPs in the Indian money market. In its observations on this instrument, the Committee had stated "the issue of commercial paper imparts a degree of financial stability to the system as the issuing company has an incentive to remain financially strong. The possibility of raising short-term finance at relatively cheaper cost would provide an adequate incentive for the corporate clients to improve the financial position and in the process the financial health of the corporate sector should show visible improvement."<sup>5</sup>

Following the recommendations of the Vaghul Committee, *the CP was introduced in the Indian money market in January 1990.* At present, a corporate having minimum credit rating of P2 of CRISIL or its equivalent can raise resources through CP. As a result, CP issuance is dominated by the prime rated companies. For instance, during the fortnight ended March 31, 2007, the prime rated companies raised funds aggregating Rs. 1,190 crore (93.0 per cent of the total) through CP at a weighted average discount rate (WADR) of 11.3 per cent, whereas medium rated companies raised funds worth Rs. 90 crore (seven per cent) at a WADR of 11.78 per cent. The outstanding amount of CP increased to Rs. 26,256 crore as on June 30, 2007. The WADR softened to 8.93 per cent in June 2007. The most preferred maturity of CP was for periods ranging from '61 days to 90 days' and '181 days and above'.

Leasing and finance companies account for the bulk of CP—two thirds of total outstanding. This would be clear from the fact that these companies accounted for 69.5 per cent of total CP outstanding as at end June 2007 (Rs. 18,260 crore out of Rs. 26,256 crore). The share of manufacturing sector was 15.1 per cent (Rs. 3,956 crore) and financial institutions 15.4 per cent (Rs. 4,040 crore).<sup>6</sup>

### Money Market Mutual Funds

*A scheme of Money Market Mutual Funds (MMMFs) was introduced by the RBI in April 1992. The objective of the scheme was to provide an additional short-term avenue to the individual investors. As the initial guidelines were not attractive, the scheme did not receive a favourable response. Hence, with a view to making the scheme more flexible, the RBI permitted certain relaxations in November 1995. The new guidelines allow banks, public financial institutions and also the institutions in the private sector to set up MMMFs. The ceiling of Rs. 50 crore on the size of MMMFs stipulated earlier, was withdrawn. The prescription of limits on investment in individual instruments by MMMFs was also deregulated. Since April 1996, MMMFs are allowed to issue units to corporate enterprises and others.*

During 1996-97 the scheme of MMMFs was made more flexible by bringing it on par with all other mutual funds by allowing investment by corporates and others. The scheme was later on made more attractive to investors by reducing the lock-in period from 45 days to 15 days. The scheme was further liberalised in 1997-98 and the MMMFs were permitted to make investments in rated corporate bonds and debentures with residual maturity of upto one year.

Resources mobilised by the MMMFs could earlier be invested exclusively in call/notice money, treasury bills, CDs, CPs, commercial bills arising out of genuine trade/commercial transactions and government securities having an unexpired maturity upto one year. The prudential measure that the exposure of MMMFs to CPs issued by an individual company should not exceed 3 per cent of the resources of the MMMF has been retained. *The MMMFs have been brought under the purview of the SEBI regulations since March 7, 2000. Banks are now allowed to set up MMMFs only as a separate entity in the form of a trust. Currently there are three MMMFs in operation.*

### ■■■■■ CHARACTERISTICS OF THE INDIAN MONEY MARKET ■■■■■

In its organization and development, the Indian money market is not comparable to either the London money market or the New York money market. It suffers from a number of defects of which the following are more prominent:

**1. Lack of integration.** As already stated, *the Indian money market is divided into two sectors, viz., the unorganised sector and the organized sector. As the two sectors are completely separate from each other, their financial operations are quite independent, and whatever goes on in one sector has little effect on the other.* Some experts assert that the country has no national money market. There are reasonably well developed local money markets; the Mumbai and the Kolkata money markets being the most prominent. The Mumbai money market, however, has been showing a tendency for quite some time to emerge as the national money market.

*There is more of competition than cooperation and co-ordination between various components of the Indian money market.* For example, cooperative banks compete with the commercial banks in the countryside. Commercial banks not only compete among themselves but also with the foreign banks. To make the matters worse, the indigenous bankers have absolutely no connections with the RBI. This sorry state of affairs in the financial system is most regrettable in the context of business needs of the country. Moreover, if even after seven decades of the establishment of RBI its monetary policy, particularly the bank rate policy has not been found sufficiently effective, then it is the lack of adequate integration in the money market that we shall have to blame.

**2. Lack of rational interest rates structure.** For a long time a major defect of the Indian money market was the lack of rational interest rates structure in it. This was particularly due to lack of adequate co-ordination between different banking institutions. Lately, situation has improved somewhat due to the authority of the Reserve Bank of India. Further, standardisation of interest rates has also introduced some rationality in the structure of interest rates. However, the system of administered interest rates suffered in the past from various defects such as: (1) relatively low yield on government securities, (2) too many concessional rates of interest, and (3) inappropriate deposit and lending rates of commercial banks. These defects in administered interest rates had led to a situation in the past in which there had always been excess demand for credit and the Reserve Bank of India had to rely often on cash reserve ratio (CRR) changes to combat inflationary pressure. *The number of administered rates on bank advances was reduced to 2 from 20 in 1989-90. Further, interest rate structure has now been deregulated.*

The RBI's efforts to introduce rationality in the interest rates structure notwithstanding, the situation in the Indian money market is still not comparable to that in the London money market where the discount rate is sufficiently effective and market rates immediately respond to changes in it. In India not only the lending rates of the State Bank of India and the commercial banks differ from those of the co-operative banks and the indigenous bankers, but their bill finance rates also differ from the Hundi rate.

**3. Absence of an organized bill market.** Though both inland and foreign bills are being purchased as well as discounted by the commercial banks, yet it cannot be said that an organized bill market exists in the country. Only a limited bill market that has been created by the RBI under its schemes of 1952 and 1970 now exists but it has failed to popularise bill finance in this country. Some experts contend that the popularity of cash credit and lack of uniformity in commercial bills proved to be serious obstacle in the development of a bill market. Moreover, *due to the presence of inter-bank call money market, commercial banks never felt the real necessity of an organized bill market.* Interestingly, the bill finance has fallen since the second scheme was introduced.

**4. Shortage of funds in the money market.** The Indian money market is characterised by shortage of funds. *Invariably demand for loanable funds in the money market far exceeds its supply.* This is attributed to a variety of factors. In the first place, savings are small due to low per capita income. Because of widespread poverty, a vast multitude of population has virtually no ability to save. Those of the people who have the ability to save often indulge in wasteful consumption. Secondly, inadequate banking facilities, lack of banking habit among the people and absence of ample and diversified investment opportunities had also contributed in the past to shortage of funds. As in the countryside banking facilities are still lacking, people have little option but to hoard their savings. Failure to mobilise them is a factor that must not be ignored, if the supply of loanable funds is to be augmented. Finally, emergence of a parallel economy and vast amount of black money in the country have also caused shortage of financial resources in the money market. In the recent past, the development of banking, particularly the opening of branches of commercial banks in the rural sector and expansion of co-operative banking have, however, improved the mobilisation of funds. This has helped in overcoming the stringency of funds to an extent, but no remedial measures are possible to remove scarcity of loanable funds in the money market caused by the acute poverty of the mass of population.

**5. Seasonal stringency of funds and fluctuations in interest rates.** India being essentially an agricultural country, farm operations have also some bearing on the demand as well as the supply of funds in the money market. From October to June when farm operations and trading in agricultural produce require additional finance, a monetary stringency is created in the money market. *Had the money market been sufficiently elastic and had it been possible to augment the supply of funds more or less automatically in response to the seasonal rise in demand, interest rates would have been very much stable.* But until recently this did not happen in this country.

**6. Inadequate banking facilities.** Though lately commercial banks have opened their branches on an unprecedented scale, yet banking facilities in the country are still somewhat inadequate. The coverage of the rural sector by the modern banks leaves much scope for further development. *Compared to the U.S.A. where per 1,200 persons there is a branch of a commercial bank, in India, we have a branch on an average for roughly 15,900 persons.* This difference is probably due to the difference in the levels of development in the two countries. An overwhelming majority of the people in this country is either below the poverty line or just at the subsistence level and does not require any banking facility. At the same time lots of people, particularly those in the countryside whose savings are small, have no access to banking facilities. Mobilisation of small savings is both difficult and uneconomic, but in an underdeveloped country like ours, where every bit of saving is to be used for productive purposes, banking facilities have to be expanded.

#### ■■■■ UNDERDEVELOPMENT OF THE MONEY MARKET IN INDIA AND MEASURES TO STRENGTHEN IT ■■■■

The detailed analysis of the Indian money market which we have presented in the foregoing pages clearly suggests that *the money market in India does not satisfy the criteria of a developed money market. Moreover, in terms of organisation, resources, stability and elasticity it is hardly comparable to the London and New York money markets.* No doubt among the Third World countries India has one of the most developed banking system. Furthermore, ever since the Banking Regulation Act was passed in 1949 the control of the RBI on the activities of the commercial banks has become quite effective. Nonetheless, the overall organization of the money market remains underdeveloped.

Banking facilities in the country even now are inadequate. *The country has also failed to develop a market in short term assets.* In the absence of the popularity of short term bonds and the treasury bills an active market in them has not emerged. The country also lacks a number of sub markets. The acceptance and the bill markets are almost non-existent in the country. *The call loan market is the core of the central part of the money market.* In this sub market commercial banks lend money to each other. *The collateral loan market is also reasonably well organized in India.* Collateral loans usually form more than half of the assets of the commercial banks and take three forms, viz., overdraft, cash credit and loan. Finally, judging on the basis of the supply of funds and the amount of liquidity the Indian money market cannot be put into the category of the developed money markets.

### Reform Measures

The RBI and the government have taken various measures to strengthen the Indian money market in recent years. Of these the following are more important:

**1. Remitting the stamp duty.** In August 1989, the government remitted the stamp duty on usance bills which was considered a major administrative constraint in the use of bill system. However, this measure has failed to induce use of commercial bills. Experts assert that unless effective measures are undertaken to discourage cash credit system, the government's decision to remit the stamp duty alone would not alter the situation in favour of the use of bill system.

**2. Deregulation of money market interest rates.** With effect from May 1, 1989 the RBI deregulated money market interest rates which proved to be a significant step towards the activation of the money market. This was expected to make interest rates flexible and lend transparency to transactions in the money market. Earlier the call/notice money was subject to interest rate ceiling of 10.0 per cent. Likewise interest-rate on inter-bank term money was subject to a ceiling of 10.5-11.5 per cent, and on rediscounting of commercial bills and inter-bank participations without risk was subject to a ceiling of 12.5 per cent.

**3. Introducing new money market instruments.** Over the past two decades or so four major money market instruments have been introduced. These are 182-day treasury bills, 364-day treasury bills, Certificates of Deposits (CDs) and Commercial Paper (CP). 182-day treasury bills were systematically promoted by the Discount and Finance House of India and were the first security sold by auction for financing the fiscal deficit of the Central government. The Discount and Finance House of India also developed a secondary market in these bills and they became popular with the banks. In 1992-93 it was decided to introduce 364-day treasury bills and the auctions of 182-day treasury bills were discontinued. 182-day treasury bills were, however, reintroduced in May 1999. Like 182-day treasury bills, 364-day treasury bills can be held by the commercial banks for meeting Statutory Liquidity Ratio.

As stated earlier, CDs have become the preferred route for mobilising resources for the cash-strapped banks. The outstanding amount of CDs rose to Rs. 93,272 crore by end-March 2007 which was 4.83 per cent of aggregate deposits of issuing banks. Smaller banks having lower deposit base had a higher ratio of CDs to aggregate deposit in comparison with large public sector banks.

CPs as money market instrument are now more than seventeen years old. The Indian CP market is driven by the demand for CP by scheduled commercial banks which, in turn, is determined by bank liquidity. The secondary activity is subdued in the Indian CP market due to most investors' preference to hold the instrument on account of higher risk-adjusted return relative to those of other instruments.

**4. Introduction of repos.** An important development in the government securities market is introduction of repos in December 1992. A repo is an instrument of repurchase agreement between the RBI and the commercial banks. *This is an asset which banks use for short-term liquidity management.* The repo rates are market determined and often fluctuate steeply. The period of repo has stabilised since August 1993 at 14 days. The repo has now become popular with banks. It can now also be effected between banks and financial institutions and banks themselves. To further develop and widen repos, in April 1999, the RBI introduced regulatory safeguards.

**5. Setting up of Discount and Finance House of India.** The Discount and Finance House of India (DFHI) was set up on April 25, 1988. Its major function is to bring into the fold of the Indian money market the entire financial system comprising of the scheduled commercial banks, foreign banks, co-operative banks and all-India financial institutions in the public and private sectors, so that their short-term surpluses and deficits are equilibrated at market related rates/prices through inter-bank transactions in case of bank and through money market instruments in the case of banks and others. In DFHI operations, the emphasis is placed on a high turnover in the money market instruments rather than on being their repository.

**6. Introducing money market mutual funds.** Money market mutual funds (MMMFs) were introduced in India in April 1991. MMMFs provide an additional short-term avenue to investors and bring money market instruments within the reach of individuals. The portfolio of MMMFs consists of short-term money market instruments.

The growth of MMMFs has been far less than expected. While in principle approvals have been granted to ten MMMFs, only three have been set up — one each by the IDBI and UTI and one in the private sector. It is hoped that with the growth of the money market in volume and depth more MMMFs would be set up.

**7. Developing call/notice money market.** The call/notice money market was mainly an interbank market until 1990. Only the Unit Trust of India and the Life Insurance Corporation were allowed to operate as lenders since 1971. During the 1990s the RBI's policy relating to entry into the call/notice money market was liberalised to provide more liquidity despite the recommendation of the Vaghul Committee that the call money market should be restricted to banks. As of now, broadly speaking banks and primary dealers (PDs) are operating as both lenders and borrowers while a number of non-bank financial institutions and mutual funds are operating only as lenders.

**8. Removing constraints on development of the term money market.** The term money market in India has always been dormant. Statutory pre-emptions on inter-bank liabilities, cash credit system of financing, the regulated interest rate structure, the high degree of volatility in the call money rates, availability of sector-specific refinance, the scarcity of money market instruments of varying maturities and the inadequate assets liability management (ALM) discipline among banks were the factors that inhibited the development of the term money market. Most of these constraints have been gradually removed by the RBI in recent years and, as a result, there is some activity in the term money market. However, despite the foregoing reforms the volumes of operations still remain rather small.

**9. Sector specific refinance facilities.** Refinance is used by central banks to meet liquidity shortage in the system, to control monetary and credit conditions and direct credit to selective sectors. The RBI has used in the past a number of sector specific refinance facilities of which export credit refinance and food credit refinance were the most prominent. Currently there are only two refinance schemes in operation — export credit refinance and general refinance. Lately with the emergence of the bank rate as the signalling rate of monetary policy stance, the RBI's policy has been to keep the refinance rate linked to the bank rate.

### Outlook for the Future

The money market is the key link in the transmission of monetary policy impulses. Accordingly, a number of measures have been undertaken in recent years with a view to improving the functioning of various segments of the money market and enhancing the smooth flow of funds across instruments and participants. According to the Reserve Bank, *“the broad policy objectives being pursued are to ensure stability, minimise default risk and achieve a balanced development of various segments through introduction of new instruments, broadening of participants' base and strengthening of institutional infrastructure.”* However, as noted by Y.V. Reddy, *“while a base has been created with a variety of products in the money market, the market has not acquired the required depth in terms of both volume and liquidity.”*<sup>8</sup> It is widely expected that the institutional and other reforms will provide the necessary depth in future. With that the Indian money market will get integrated with debt and foreign exchange markets and may pave the way for the Reserve Bank's increased use of indirect tools of monetary regulation.

### ■■■■ NOTES ■■■■

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# CAPITAL MARKET IN INDIA

## Capital Market

### Structure of the Capital Market

- Gilt-Edged Market • Corporate Securities Market

### Role of Capital Market in India's Industrial Growth

### Growth of Capital Market in India

- Government Securities Market • Corporate Securities Market

### Factors Contributing to the Growth of Capital Market in India

### Problems of Indian Capital Market : The Pre-Reform Phase

- Problems of the Equity Market • Problems of the Debt Market

### Strengthening the Capital Market : The Post-Reform Phase

- Steps to Strengthen the Government Securities Market • Securities and Exchange Board of India (SEBI) • National Stock Exchange of India • National Securities Clearing Corporation • Dematerialisation

Every business unit needs money to finance its activities. The money is invested in physical resources, *i.e.* land and building, machines and equipment, stock of raw materials, etc., which are used by the enterprise in production. All these resources together constitute 'capital'. *Capital is often defined as "wealth used in the production of further wealth"*. In simple words, it comprises the money and the money value invested in a business unit. In this chapter we propose to address the following questions:

- What is the capital market? What is the structure of the capital market?
- What is the role of capital market in India's industrial growth? What are the trends of growth in India's capital market?
- What factors have contributed to the growth of capital market in India?
- What were the problems being faced in the development of the capital market in the pre-reform phase?
- What steps have been taken by the Government of India to strengthen the capital market since 1991?

## ■■■■ CAPITAL MARKET ■■■■

A business enterprise can raise capital from various sources. Long-term funds can be raised either through issue of securities or by borrowing from certain institutions. Short-term funds can also be borrowed from various agencies. Thus business units can raise capital from issue of securities and borrowings (long-term and short-term). In addition to business units, public corporations and governments (the Central government, the State and local governments), are the other major borrowers of funds. The lenders of funds include the individual investors (the household sector), the institutional investors, banks, and special industrial financing institutions. The borrowers and lenders are brought together through the financial markets. *The term 'financial market' collectively refers to all those organisations and institutions which lend funds to business enterprises and public authorities.* It is composed of two constituents—the money market and the capital market. While

the former deals with the provision of short-term credit, the latter deals with the grant of medium-term and long-term credit.

We have already discussed the Indian money market in the chapter 'Indian Money Market'. In the present chapter, we propose to discuss the Indian capital market. However, before we do so, it is important to point out that both money market and the capital market are interdependent. The reasons for their interdependence are as follows: (1) Most of the suppliers prefer to operate in both the markets. Within the framework of their investment policies, they look for the best opportunities wherever they may exist. For example, most of the individuals who operate saving bank accounts in their names also take insurance policies on their lives. (2) Users of the funds also have the option to obtain funds from either market. Exercising this choice, businessmen generally borrow in the market which offers them easy terms. (3) Funds freely flow between the two markets in a variety of ways. (4) The short-term and long-term rates of interest are interdependent. It is generally the short-term interest rates that change first and this brings about a change in long-term interest rates as well. (5) Some institutions serve both money and capital markets. For example, commercial banks constituting the core of the money market provide intermediate loans also. Similarly, dealers in short-term government securities buy and sell long-term bonds also.

### ■■■■ STRUCTURE OF THE CAPITAL MARKET ■■■■

Broadly speaking, the capital market can be divided into two constituents : (1) the *financial institutions*, and (2) the *securities market*. The financial institutions, e.g., IFCI, IDBI, Exim Bank, SIDBI, IDFC, SFCs, LIC, etc. provide long-term and medium-term loan facilities. These institutions are discussed in detail in Chapter 52. The securities market is divided into (i) the gilt-edged market (or the market for government securities), and (ii) the corporate securities market.

#### Gilt-Edged Market

*The gilt-edged market is the market in government securities or the securities guaranteed (as to both principal and interest) by the government.* Since the government cannot default on its payment obligations, the government securities are risk free and hence are known as *gilt-edged* (which means 'of the best quality'). Important features of the government securities market are as follows:

1. It is a risk free market and returns are guaranteed. Accordingly, there is no uncertainty regarding yield, payments on time, etc. and there is no scope for speculation and manipulation of the market.
2. The government securities market consists of two parts—the new issues market and the secondary market. Since it is the Reserve Bank of India that manages entirely the public debt operations of the Central as well as the State governments, it is responsible for all the new issues of government loans. The secondary market deals in old issues of government loans and operates largely through a few large stockbrokers who keep in touch with the Reserve Bank and other prospective buyers and sellers. Reserve Bank, on its part, keeps on ready sale securities of various maturities to meet the market demand for them.
3. Reserve Bank of India plays a dominant role in the government securities market. In fact, its position is that of a monopolist. As noted by S.B. Gupta, "there are only brokers or investors in the market and no dealers or jobbers (other than the RBI) who would make a market in government loans by standing ready to buy and sell any amount of government securities on their own account."<sup>1</sup> This special feature of India's gilt-edged market distinguishes it from the gilt-edged markets of many countries (like U.K., USA etc.) where the central bank of the country is not the sole dealer in government securities.
4. The investors in the gilt-edged market are predominantly institutions which are required statutorily to invest a certain portion of their funds in government securities. These institutions include commercial banks, the LIC, the GIC and the provident funds. They mobilise the savings of the people through their various schemes and invest a certain proportion in government securities. They constitute what is called the *captive market* for government securities.
5. Government securities are the most liquid debt instruments.
6. The transactions in the government securities market are very large and each transaction may run into several crores of rupees.
7. For several years, the government securities market in India has been an 'over the counter market' (and not an auction market). However, since June 1992 (barring a few issues) government securities have been mostly issued through a system of first price sealed-bid auctions. In this system of auction, "When auctioning



a single unit, the highest bidder is awarded the item at the bid price. The auction of multiple units is called *discriminatory auction*, which involves awarding of stock to the highest bidders at the prices and quantities quoted in their bids until the supply is exhausted.”<sup>2</sup> The government’s preference to auction system to other mechanisms for selling securities emanates from the ability of auctions to reveal more information about price determination and improve the allocation process.

On account of the risk-free returns guaranteed by the government securities market and its high liquidity, many private sector mutual funds have entered this market in a considerable way in recent times and have floated various gilt-edged funds for this purpose (these include Kotak Mahindra Mutual Fund, Templeton AMC, Dundee AMC, Prudential-ICICI AMC, UTI, Tata Mutual Fund, JM Mutual Fund etc.). Many individual investors (particularly those belonging to fixed-income groups) who are averse to risk taking have welcomed this opportunity as investment in gilt-edged funds is better than investment in bank fixed deposits due to better liquidity and exemption from tax on dividends.

### Corporate Securities Market

*Corporate securities market is a market where securities issued by firms (i.e. shares, bonds and debentures) can be bought and sold freely.* It consists of the new issues market (the primary market) and the stock exchange (the secondary market).

**The New Issues Market.** *The new issues market is that part of the capital market which is concerned with the issue of new securities, i.e. bonds, debentures, shares, and so on.* The public limited companies often raise funds through the primary market for setting up or expanding their business. However, to sell securities is not an easy task as the company has to fulfil various requirements and decide upon the appropriate timing and method of issue. It is quite normal to obtain the assistance of underwriters, merchant banks or special agencies to look after these aspects. The various methods through which capital can be raised are:

**1. By prospectus.** Capital can be raised from the general public by the issue of prospectus. The prospectus is an invitation to the general public for subscribing to the capital. The prospectus must contain various details regarding particulars of the company, its financial position, etc.

**2. By offer for sale.** This method is almost similar to the prospectus method except with a difference that initially shares are taken up by a third party in bulk. Later, a statement like prospectus is issued for sale of shares to the public. The peculiar feature of this arrangement is that the company has already received the money and any premium received from the public goes to this third party rather than to the company.

**3. By private placing.** Under this arrangement, the shares are sold to individuals or institutions directly by making a private appeal to them. This results in substantial saving as the cost of raising capital in this method is less than the cost of raising capital via other methods.

**4. By offering rights issue.** Companies may also raise capital from the existing shareholders by making a rights issue. Under a rights issue, the shareholders have the right to a certain number of shares in proportion to the shares held by them.

**The Stock Exchange.** *The stock exchange (or the secondary market) is a highly organised market for the purchase and sale of second-hand quoted or listed securities* (‘quoting’ or ‘listing’ of a particular security implies incorporating that security in the register of the stock exchange so that it can be bought and sold there). The Securities Contracts (Regulation) Act, 1956 defines a stock exchange as “an association, organisation or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling business in buying, selling and dealing in securities”.

### ■■■■■ ROLE OF CAPITAL MARKET IN INDIA'S INDUSTRIAL GROWTH ■■■■■

**1. For financing Five Year Plans.** Government securities have become an important part of the capital market in many developing countries as the pressure of providing funds for carrying out plans has built up. In India, the government securities have played an important part in raising resources for financing five year plans. In many years the government was able to appropriate for itself as much as 50 per cent of the savings of the household sector in the form of financial assets (running into thousands of crores of rupees) through the device of Treasury bills and market loans sold to bank and other institutions.

**2. Mobilisation of savings and acceleration of capital formation.** In developing countries like India plagued by paucity of resources and increasing demand for investments by industrial organisations, the importance of the capital market is self-evident. In this market, various types of securities help mobilise savings from

various sections of the population. The twin features of reasonable return and liquidity in the stock exchange are definite incentives to the people to invest in securities. This accelerates the capital formation in the country.

**3. Promotion of industrial growth.** The stock exchange is a central market through which resources are transferred to the industrial sector of the economy. The existence of such an institution encourages people to invest in productive channels rather than in the unproductive sectors like real estate, bullion etc. Thus it stimulates industrial growth and economic development of the country by mobilising funds for investment in the corporate securities.

**4. Raising long-term capital.** The existence of a capital market enables companies to raise permanent capital. The investors cannot commit their funds for a permanent period but companies require funds permanently. The stock exchange resolves this clash of interests by offering an opportunity to investors to buy or sell their securities while permanent capital with the company remains unaffected.

**5. Ready and continuous market.** The stock exchange provides a central convenient place where buyers and sellers can easily purchase and sell securities. The element of easy marketability makes investment in securities more liquid as compared to other assets.

**6. Proper channelisation of funds.** An efficient capital market not only creates liquidity through its pricing mechanism but also functions to allocate resources to the most efficient industries. The prevailing market price of a security and relative yield are the guiding factors for the people to channelise their funds in a particular company. This ensures effective utilisation of funds in the public interest.

**7. Provision of a variety of services.** The financial institutions functioning in the capital market provide a variety of services, the more important ones being the following: (i) grant of long-term and medium-term loans to entrepreneurs to enable them to establish, expand or modernise business units; (ii) provision of underwriting facilities; (iii) assistance in the promotion of companies (this function is done by the development banks like the IDBI); (iv) participation in equity capital; and (v) expert advice on management of investment in industrial securities.

## ■■■■ GROWTH OF CAPITAL MARKET IN INDIA ■■■■

### Government Securities Market

Since 1991, the investor base for government securities has expanded rapidly. Besides banks and insurance corporations, finance companies, corporates and financial institutions have also begun to invest in government securities. The maturity structure of debt has significantly shifted in favour of medium-term and short-term borrowings. The amount of market-based primary issuance of government securities which was about Rs. 12,000 crore in 1991-92 rose to as high Rs. 99,630 crore in 1999-2000. The gross market borrowings of the Central and State governments rose to Rs. 1,81,747 crore during 2005-06.

As far as secondary market is concerned, a deep, wide and vibrant gilt-edged market has emerged as a result of a series of structural and institutional reforms. The secondary market turnover of government securities registered spectacular increase since mid-1990s. This is due to a substantial rally in the government securities market.

Secondary market transactions in Government securities amounted to Rs. 2,86,293 crore in July 2006 and Rs. 5,01,808 crore in July 2007.<sup>3</sup> The turnover in the Government securities market is closely linked with the movements in yields. For instance, during the period of rising yields (April-July 2006 and December 2006-March 2007), the turnover was subdued as banks preferred to hold securities rather than trade. During the period (August-November 2006) of softening in the yields, the turnover witnessed a sharp increase.<sup>4</sup>

### Corporate Securities Market

Consequent upon the policy of liberalisation adopted by the government in July 1991 and the subsequent abolition of Capital Issues Control with effect from May 29, 1992, the corporate securities market got a tremendous boost as the following discussion clearly brings out.

#### (1) Primary Market or the New Issues Market

**New Capital Issues by Private Sector.** The number of new capital issues by private sector was only 364 in 1990-91 and the amount raised by them was Rs. 4,312 crore. The number of new issues rose to 1,040 in 1992-93 and the amount raised by them to Rs. 19,803 crore. These figures were 1,678 and Rs. 26,417 crore

### BOX 49.1. Government Securities Act, 2006

Management of Government debt involves issuance and servicing of Government securities. The servicing of Government debt requires timely payment of interest and principal to the holders of Government securities and settlement of claims in the event of death of the holder. The issue of Government securities and their servicing is attended to by the Reserve Bank through the Public Debt Offices, the branches of State Bank of India/associate banks and the district treasuries/sub-treasuries.

The legal framework relating to issuance and servicing of Government securities was provided by the Public Debt Act, 1944. In view of the sharp increase in the volume of the public debt and other changes in the external environment, some of the provisions of the Act and the Rules framed thereunder were found to be onerous, and, at times, impeded further development of the debt market. Accordingly, the Government Securities Act, 2006 was enacted, which seeks to replace the Public Debt Act, 1944 and repeal the Indian Securities Act, 1920.

The Act proposes to consolidate and amend the law relating to issue and management of Government securities by the Reserve Bank.

The Act, *inter alia* provides for (i) definition of terms such as 'bond ledger account, 'constituent subsidiary ledger account' and 'Government security'; (ii) recognition of title to Government security of deceased sole holder or joint holders; (iii) nomination by holders of Government securities; (iv) acceptance of micro films, facsimile copies of documents, magnetic taps and computer printouts as documents of evidence; (v) suspension of the holders of subsidiary general ledger account from trading with the facility of that account in the event of misuse of the said facility; (vi) stripping of a Government security separately for interest and principal; (vii) creation of pledge, hypothecation or lien in respect of Government securities. The Act also empowers the Reserve Bank to call for information, cause inspection and issue directions as well as to make regulations with the prior approval of the Central Government for carrying out the purposes of the Act.

The Rules under the Act are yet to be notified.

**Source:** Reserve Bank of India, Annual Report, 2006-07 (Mumbai, September 2007), Box 1.4, p. 14.

for the year 1994-95. However, mobilisation by private sector companies declined consecutively for three years during 1995-96 to 1997-98 at an average annual rate of 48.1 per cent. The resource mobilisation during 1997-98 was only of the order of Rs. 3,138 crore though it picked up somewhat to Rs. 5,013 crore in 1998-99 and further to Rs. 5,962 crore in 2001-02. Thereafter, resources raised by Indian private sector corporates declined for two years. In 2002-03, Indian private companies could raise only Rs. 1,878 crore which was the lowest in the post-liberalisation phase. However, resource mobilisation by private sector through capital issues picked up considerably thereafter and rose to Rs. 21,154 crore in 2005-06 and Rs. 31,600 crore in 2006-07.

Capital issues consist of two parts—shares and debentures. Prior to 1992-93, debentures were a more popular means of raising long-term funds and provided almost 70 per cent or more resources raised through new capital issues. For instance, they provided 69 per cent of resources raised through this means in 1991-92. In 1992-93 and 1993-94, shares provided a little more resources than debentures. However, thereafter, for three years, there was distinct bias in favour of shares. The year 1997-98 again saw a reversal in the preference order of the investors as only 37 per cent of resources were raised through shares. Shares accounted for a mere 12 per cent of the resources raised through new capital issues in 2001-02 while as much as 88 per cent of resources were raised through debentures. Thereafter, the position changed significantly. In 2003-04, 66.4 per cent, in 2004-05, 87.6 per cent, in 2005-06, 99 per cent, and in 2006-07, 97 per cent of the resources were mobilised through equity issuances.

The persons who hold shares are known as shareholders or members and are part owners of the company. So, they enjoy certain rights like voting power, receipt of profits in the form of dividends etc. A company can issue two types of shares, namely, equity shares and preference shares. The preference shares carry fixed rate of dividend or enjoy preference in respect of payment of dividend and repayment of capital in the event of the company being wound up. Unlike preference shares, equity shareholders are not guaranteed any dividend because it depends upon the yearly profits. Therefore, equity shareholders face maximum risk in the company. However, equity shares have a chance of earning more than preference shares in years of prosperity. In fact, equity shares have now become a much favoured form of investment in our country as would be clear from the fact that almost the entire amount raised through shares in recent years has been through the floating of equity shares.

As against shareholders, debenture holders do not have any share in the ownership of a company. Debentures are merely loans which carry fixed rate of interest and must be paid annually. Debentures can either be convertible or non-convertible. Convertible debentures are those debentures which can be converted into equity capital at a fixed date or after a specified period. Non-convertible debentures do not carry any such rights. These days partly convertible debentures have become quite popular. These debentures have two parts—one convertible into equity shares at a fixed time and the other non-convertible. New instruments introduced in

recent years are non-convertible debentures (NCDs) with detachable equity warrants, zero interest fully convertible debentures (FCDs), secured zero interest partly convertible debentures (PCDs) with detachable and separately tradeable warrants, fully convertible debentures with interest (optional), zero interest secured redeemable multi-option convertible debentures, etc.

**Debt Market.** *The Indian debt market is composed of government bonds and corporate' bonds.* Debt Market is however dominated by government bonds. Bonds issued by the Central government, i.e., the Government of India are the predominant and most liquid component of the bond market. Government bonds are usually much less volatile than equities and far more liquid than equities. As compared to issuance of bonds by the corporates in the five year period from 2002 to 2006, the gross issuance of Government of India bonds in these years was substantially larger.

TABLE 49.1. Issuance of Bonds

	For calendar year				
	2002	2003	2004	2005	2006
Government of India bonds	1,20,213	1,13,000	1,19,600	1,29,350	1,47,000
Corporate Bonds	4,549	5,284	2,383	66	389

(Rs. Crore)

Source: *Economic Survey 2005-06*, pp.68 and 74 and *Economic Survey 2006-07*, pp. 70 and 76.

**Mutual Funds.** The mutual funds (MFs) have proved to be important conduits of mobilising resources particularly since 1987-88 when the public sector banks were allowed to set up subsidiaries to undertake mutual fund business. *At present this country has four types of mutual funds - Unit Trust of India, MF subsidiaries of public sector banks, MF subsidiaries of investment institutions like LIC and GIC, and private sector MFs.* Resources mobilised by the MFs (including UTI) under various schemes rose substantially from Rs. 2,310 crore in 1987- 88 to Rs. 13,021 crore in 1992-93. In 1994-95, resources mobilised by MFs stood at Rs. 11, 243 crore. There was a reverse flow of funds from the mutual funds during 1995-96 and 1996-97 in view of the sluggishness in the capital market. During 1995-96 and 1996-97, the total funds raised by the MFs aggregated a negative amount of Rs. 5,833 crore and Rs. 2,037 crore respectively, mainly due to high level of repurchases coupled with inability on the part of mutual funds to float new schemes in a downward market. However, in 1997-98 and 1998-99, the mutual funds were able to mobilise Rs. 4,064 crore and Rs. 2,695 crore respectively. In 1999-2000 there was a spectacular increase in resource mobilisation by the mutual funds. The total resources raised by the mutual funds under various schemes amounted to Rs. 22,113 crore. However, this amount fell to Rs. 10,120 crore in 2001-02 and to Rs. 4,583 crore in 2002-03. In 2003-04, total mobilisation of resources by the mutual funds amounted to Rs. 47,873 crore largely due to spectacular mobilisation by private sector mutual funds. In 2004-05 there was a steep fall in resource mobilisation through mutual funds. It was as low as Rs. 2,201 crore. The situation changed thereafter. Resource mobilisation by mutual funds rose to Rs. 52,779 crore in 2005-06 and further to Rs. 93,985 crore in 2006-07 (a hefty increase of 78.1 per cent over the previous year).<sup>5</sup>

## Secondary Market

*Secondary market refers to stock exchanges where existing securities can be regularly purchased and sold.* These markets are an important element in mobilisation of resources. They enhance the efficiency of the flow of savings. The existence of these markets fulfils a basic need of the investors namely the liquidity. In these markets, holders of securities can easily dispose of their securities and obtain cash. Thus viable secondary markets by providing marketability to securities encourage savers to take risk and make investments in the existing securities. In this process, savings of the households become available to private and public corporates which in turn greatly simulate production activity. Stock market is discussed in detail in Chapter 50. Here we merely provide a brief information of the two top stock exchanges of the country — NSE (National Stock Exchange) and BSE (Bombay Stock Exchange).

**NSE and BSE.** The biggest stock exchange of India is the National Stock Exchange (NSE) which was set up in November 1992. It started its trading operations effective June 30, 1994. Only the debt market segment of the NSE was put into operation initially. The equity market segment of the NSE commenced its operation on November 3, 1994. The NSE very soon attained a much greater volume than the Bombay Stock Exchange which was the biggest stock exchange till NSE began its operations. NSE's growth was an unprecedented

success for a new stock exchange. Competition from the NSE led to substantial reduction in the transactions costs which are now among the lowest in the world. Now, the NSE provides facilities for trading of equity instruments, warrants, debentures, preference shares etc. NSE has adopted fully automated screen based trading system which allows trading members to trade from their office through a communication network. The exchange has opened membership to a number of cities.

The second largest stock exchange in India is the Bombay Stock Exchange (BSE). It was the first organised stock exchange established in India at Mumbai as far back as 1887. Presently NSE and BSE account for almost the entire trading of scrips on Indian stock markets and most of the regional stock exchanges have been rendered redundant. For example, the total turnover of scrips on Indian market in 2005-06 was Rs. 23,09,012 crore of which Rs. 15,69,556 crore (65.7 per cent) was the share of NSE and Rs. 8,16,074 crore (34.1 per cent) was the share of BSE.<sup>6</sup>

### ■■■■ FACTORS CONTRIBUTING TO THE GROWTH OF CAPITAL MARKET IN INDIA ■■■■

The above discussion brings out clearly the massive expansion of the capital market that has taken place in the Indian economy over the years. The growth has been particularly marked during the period following the liberalisation of economic policy in the industrial, financial and foreign trade sectors in 1991 although there have been setbacks in certain years. What is to be noted is that despite the setback, the turnover and trading in the capital market is now much more than it was, say, a decade back. Let us now list the factors that have contributed to the growth of capital market in India.

**1. Establishment of development banks and industrial financing institutions.** With a view to providing long-term funds to industry, the government set up the Industrial Finance Corporation of India (IFCI) in 1948, i.e., soon after Independence. This was followed by the setting up of a number of other development banks and financial institutions like the Industrial Credit and Investment Corporation of India (ICICI) in 1955, Industrial Development Bank of India (IDBI) in 1964, Industrial Reconstruction Corporation of India (IRCI) in 1971, various State Financial Corporations (SFCs) at the State Level, Unit Trust of India (UTI) in 1964, State Industrial Development Corporations, Life Insurance Corporation of India etc. In addition, 14 major commercial banks were nationalised in 1969. Another 6 banks were nationalised in 1980. These financial institutions and development banks have contributed significantly to the widening and strengthening of the capital market in India. ICICI ceased to be a development bank after its merger with ICICI bank with effect from March 30, 2002.

**2. Legislative measures.** The Government passed the Companies Act in 1956. This Act gave considerable powers to the government to control and direct the development of the corporate enterprises in the country. The Capital Issues (Control) Act was passed in 1947 to regulate investment in different enterprises, prevent diversion of funds to non-essential activities, and to protect the interest of investors. The Act was repealed in 1992 as it was felt that the Act had become too restrictive and was hampering the growth of the capital market.

**3. Growth of underwriting business.** Mainly due to the efforts of the public financial institutions and the commercial banks, the underwriting business in India has been growing rapidly. This has contributed significantly to the development of the capital market in India.

**4. Growing public confidence.** The early post-liberalisation phase witnessed increasing interest in the stock markets. The small investor who earlier shied away from the securities market and trusted the traditional modes of investment (deposits in commercial banks and post offices) showed marked preference in favour of shares and debentures. As a result, public issues of most of the good companies were over-subscribed many times. However, during some years in the recent period, many retail investors withdrew from the securities market due to stock market scams and the lacklustre performance of many companies.

In recent times, with withdrawal of tax on dividends, investment in gilt-edged market (through the various schemes floated by mutual funds) has attracted the attention of many individual investors who now regard it as a better option than investment in fixed deposits of banks. This is due to the reason that while investment in gilt-edged market is as risk-free as in the case of bank fixed deposits, it is more liquid *vis-a-vis* the latter.

**5. Increasing awareness of investment opportunities.** The last few years have witnessed increasing awareness of investment opportunities among the general public. Business newspapers and financial journals (*The Economic Times, Business Line, The Financial Express, Business Standard, Business India, Business*

Today, *Businessworld*, *Outlook Money* etc.) have made the people increasingly aware of new long-term investment opportunities in the securities market.

**6. Setting up of SEBI.** The Securities and Exchange Board of India (SEBI) was set up in 1988 and was given statutory recognition in 1992. Among other things, the Board has been mandated to create an environment which would facilitate mobilisation of adequate resources through the securities market and its efficient allocation.

**7. Mutual funds.** In 1997-98 there were 34 mutual funds in the country (including UTI). Of these, 9 were in the public sector and 25 in the private sector. During the period 1991-92 to 1994-95, the mutual funds could mobilise substantial resources on account of strong investor support. In each of these years, these funds were able to mobilise more than Rs. 11,000 crore—UTI alone contributing around 76 to 85 per cent of total mobilisation. In 1994-95, total resources mobilised by mutual funds stood at Rs. 11,275 crore. Of this, UTI contributed 76 per cent, other public sector mutual funds 12 per cent and private sector mutual funds 12 per cent. However, during 1995-96 and 1996-97, there was a reverse flow of funds from the mutual funds on account of sluggishness in the capital market. Thereafter, things improved. In fact, resources mobilised by mutual funds touched the high level of Rs. 93,985 crore in 2006-07.

**8. Credit rating agencies.** There are three credit rating agencies operating in India at present—CRISIL, ICRA and CARE. CRISIL (the Credit Rating Information Services of India Limited) was set up in 1988, ICRA Ltd. (the Investment Information and Credit Rating Agency of India Limited) was set up in 1991 and CARE (Credit Analysis and Research Limited) was set up in 1993. Credit ratings by these agencies have been providing guidance to investors/creditors for determining the credit risk associated with a debt instrument. This is likely to help in the healthy development of the capital market in future.

## ■■■■ PROBLEMS OF INDIAN CAPITAL MARKET: THE PRE-REFORM PHASE ■■■■

### Problems of the Equity Market

According to Ajay Shah, in the pre-reform phase (i.e. the pre 1991 period) the Indian equity market was confronted with a number of problems, the chief among them being as follows:<sup>7</sup>

1. As of 1992, the Bombay Stock Exchange (BSE) was a monopoly. It was an association of brokers, and imposed entry barriers, which led to increased costs of intermediation.
2. Trading took place by 'open outcry' on the trading floor, which was inaccessible to users. It was usual for brokers to charge the investor a much higher price from that actually traded at.
3. As with all trading-floors, there was no price-time priority, so users of the market were not assured that a trade was executed at the best possible price.
4. A variety of manipulative practices prevailed, so that external users of a market often found themselves at the losing end of price movements. No strict action could be taken against errant brokers.
5. Retail investors, and particularly users of the market outside Mumbai, accessed market liquidity through a chain of intermediaries called 'sub-brokers'. Each sub-broker in the chain introduced a mark-up in the price and the investor thus had to pay a much higher price than the actual trade price.
6. The markets used 'future-style settlement' with fortnightly settlement. This means that trading was supposed to take place for a fortnight until a pre-determined 'expiration date'. Open positions on the expiration date only would go into actual settlement where funds and securities were exchanged. According to Shah, in practice, there was little discipline on ensuring a reliable fortnightly settlement cycle.
7. A peculiar market practice called *badla* allowed brokers to carry positions across settlement periods. In other words, even open positions at the end of the fortnight did not always have to be settled.
8. The efficiencies of the exchange clearing house only applied for the largest 100 stocks. For other stocks, clearing and settlement were done bilaterally, which introduced further inefficiencies and costs.
9. The use of futures-style trading for a fortnight (or more) coupled with *badla* was fraught with counterparty risk. Counterparty risk in the small (at the level of one market participant) can sometimes become counterparty risk in the large (at the level of the entire market) owing to *cascading defaults*. The latter can lead to a payment crisis and the entire exchange could collapse. This has happened a number of times in Indian exchange market. In April 1995 in the context of M.S. Shoes, a default involving a total exposure of Rs. 18 crore led to a payment crisis on the BSE which halted the functioning of the exchange for three days.
10. Floor based trading, inefficiencies in clearing and settlement, entry barriers into brokerage, and low

standards of technology and organisational complexity led to an environment where order execution was unreliable and costly. It was typical for below 50 per cent of orders to obtain execution on a given day.

11. The final leg of the trade was physical settlement, where share certificates were printed on paper. This was intrinsically vulnerable to theft, counterfeiting, inaccurate signature verification, administrative inefficiencies and a variety of other malpractices. Moreover, the entire process of share transfer was time consuming and cumbersome. For investors outside Mumbai, the entire process could well take six months or even more.

### Problems of the Debt Market

According to Ajay Shah, the Indian debt market faced the following important problems in the pre-reform phase:

1. In 1992, debt trading took place without an exchange in the picture. Trades were bilaterally struck between known counterparts without anonymity. Personal and political influences impacted upon trade prices; each leg of the transaction was exposed to the credit risk of the other; dealer markets suffered from a fragmentation of orders and trades; and there was no price-time priority to ensure that each trade took place at the best price in the country.

2. The problem of credit risk served to narrow the market down to a 'club market', a set of participants with homogeneous credit risk.

3. The lack of anonymity made it easier to form and enforce cartels which would indulge in a lot of manipulative practices.

4. The debt market relied on dealers who, as with the Bombay Stock Exchange, did not unbundle their intermediation price from the transaction price. Therefore one could not shop around looking for a dealer with the lowest intermediation charges. Also, there was no guarantee of obtaining the best price, owing to the absence of price-time priority.

5. Trading took place by telephone in Mumbai. Hence, the debt market was effectively restricted to Mumbai.

6. Since trades took place bilaterally, trade prices were not centrally reported and observed, even *ex post*.

7. There were serious problems with the settlement of trades. The Reserve Bank tracks ownership of government securities in a database called the SGL (Subsidiary General Ledger). SGL was maintained manually.

8. According to Shah, market participants faced the risk of an SGL request "bouncing". Suppose A sold to B and then B sold to C. When B sent the change of title to SGL, there was a risk that this request would bounce if the first trade (B buying from A) had not yet taken effect. Thus, the market participants resorted to the exchange of 'bankers' receipts (BRs)' which were IOUs for bonds. The purchase and sale of these IOUs effectively constituted highly leveraged transactions in the absence of internal controls and risk management.

9. The protracted delays involved in settlement, coupled with the 'open interest' in the form of outstanding IOUs, led to grave reconciliation problems in the back offices of banks.

10. According to Shah, the complexity of reconciliation coupled with the inefficiency of the bank office made it easy for dealers to disguise soft loans to favoured counterparties, implemented in this fashion, from their superiors. This was the mechanics of how funds from the banking system found their way into *badla* financing on the BSE. On account of this reason, Shah prefers to call the 'stock market scam of 1992' as the 'debt and stock market scam of 1992'.<sup>8</sup>

### ■■■■ STRENGTHENING THE CAPITAL MARKET: THE POST-REFORM PHASE ■■■■

In the post-reform phase (more particularly, from late 1993 onwards) the Government of India has initiated a number of steps to strengthen the Indian capital market. A brief discussion of some of the measures follows:

#### Steps to Strengthen the Government Securities Market

1. The auction system for the sale of Government of India medium and long-term securities was introduced from June 3, 1992. Some innovative instruments, such as, conversion of auction Treasury Bills into term securities, Zero Coupon and Capital Indexed Bonds, Tap Stocks and partly paid stocks were introduced.

2. 364-day Treasury Bills auctions were introduced from April 28, 1992 and 91-day Treasury Bills auctions from January 8, 1993. 14-day Treasury Bills were introduced on June 6, 1997, while 182-day Treasury Bills were reintroduced on May 26, 1999. Auctions of 14-day Treasury Bills and 182-day Treasury Bills was discontinued from May 14, 2001. However, auction of 182-day Treasury Bills was resumed from April 5, 2005.
3. The Government of India set up the Securities Trading Corporation of India (STCI) to develop institutional structure for a vibrant secondary market in government securities. STCI was set up with total capital of Rs. 500 crore and it commenced operations from June 1994.
4. A scheme of 14-day Intermediate Treasury Bills was introduced effective April 1997 to enable State governments, foreign central banks and other specified bodies with whom the Reserve Bank has an arrangement to invest their temporary surplus funds.
5. A system of Primary Dealers was established in March 1995 and the guidelines for Satellite Dealers were issued in December 1996.
6. Market orientation to issues of government securities paved the way for the Reserve Bank to activate the open market operations as a tool of market intervention.
7. The practice of automatic monetisation of the Central government budget deficit through *ad hoc* Treasury Bills was replaced with effect from April 1, 1997 by a new scheme of Ways and Means Advances (WMA).
8. The Delivery *versus* Payment system (DvP) was introduced in 1995 for the settlement of transactions in government securities. A screen-based trade reporting system with the use of VSAT Communication Network complemented by a centralised Subsidiary General Ledger (SGL) accounting system was put in place.
9. The Negotiated Dealing System (NDS) (Phase I) was operationalised in February 2002 to enable on-line electronic bidding facility in the primary auctions of Central/State government securities.
10. Since timely information is a critical factor in evolving the efficient price discovery mechanism, improvements were brought in transparency of operations and data dissemination.
11. A practice of pre-announcing a calendar of treasury bills and government securities auctions to the market was introduced.
12. Foreign institutional investors were allowed to set up 100 per cent debt funds to invest in government (Central and State) dated securities in both primary and secondary markets.
13. Retail trading in government securities at select stock exchanges commenced in January 2003.

### Securities and Exchange Board of India (SEBI)

The Securities and Exchange Board of India (SEBI) set up in 1988 was given statutory recognition in 1992 on recommendations of the Narasimham Committee. Among other things, the Board has been mandated to create an environment which would facilitate mobilisation of adequate resources through the securities market and its efficient allocation by SEBI. The purposes and aims of SEBI are as follows: (1) regulating the business in stock markets and other securities markets; (2) registering and regulating the working of stock brokers and other intermediaries associated with the securities markets; (3) registering and regulating the working of collective investment schemes including mutual funds; (4) promoting and regulating the self-regulatory organisations; (5) prohibiting fraudulent and unfair trade practices relating to securities markets; (6) promoting investors' education and training of intermediaries of securities market; (7) prohibiting insider trading in securities; (8) regulating substantial acquisition of shares and takeover of companies; and (9) performing such functions and exercising such powers under the provisions of the Capital Issues (Control) Act, 1947 and Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central government.

SEBI has been vested with wide-ranging powers. *Firstly*, to oversee constitution as well as the operations of mutual funds including presentation of accounts, following the decision to allow the entry of private sector and joint sector mutual funds. *Secondly*, all stock exchanges in the country have been brought under the annual inspection regime of SEBI for ensuring orderly growth of stock markets and investors protection. *Thirdly*, with the repealing of the Capital Issues (Control) Act, 1947, in May 1992, SEBI has been made the regulatory authority in regard to new issues of companies. An amendment to the SEBI Act (1992) carried out on March 25, 1995 has empowered SEBI to register and regulate new intermediaries in the capital market. With this empowerment, all intermediaries associated with this securities market are now regulated by SEBI.



### National Stock Exchange of India

As stated earlier, NSE was set up in November 1992 and was owned by IDBI, UTI and other public sector institutions. It commenced its operations in 1994. NSE is a securities exchange which marks a radical break with the past. According to Ajay Shah, the regime in which trading on NSE operates is characterised by four key innovations<sup>9</sup>: (1) The physical floor was replaced by anonymous, computerised order-matching with strict price-time priority. (2) The limitations of being in Mumbai, and the limitations of India's public telecom network, were avoided by using satellite communications. Now NSE has a network of 2,000 satellite terminals all over the country. On a typical day, almost 3,500 traders log in to the trading computer over this network. "This is larger than the capacity of the largest trading floors in the world." (3) NSE is not 'owned' by brokers. It is a limited liability company, and brokers are franchisees. Therefore, NSE's staff is free of pressures from brokers and is able to perform its regulatory and enforcement functions more effectively. (4) Traditional practices of unreliable fortnightly settlement cycle with the escape clause of *badla* were replaced by a strict weekly settlement cycle without *badla*.

As stated earlier, equity trading at NSE commenced in November 1994. The BSE responded rapidly by moving to similar technology in March 1995. According to Ajay Shah, the improvements that accompanied this regime were as follows: (i) *transparency*—users could look at a price on a computer screen before placing an order; (ii) *anonymity*—electronic trading is completely transparent about prices and quantities, and completely opaque about identities; (iii) *competition in the brokerage industry*—as a result of NSE, about 1,000 new brokerage firms have entered the market. This has reduced transaction costs sharply (through lower brokerage fees); (iv) *operational efficiency*—automation eliminated the vagaries of manual trading; and (v) *gains outside Mumbai*—NSE's satellite based trading gave equal access to the trading floor from all locations in India. This has helped the user outside Mumbai and has been a major impetus to the development of financial sector outside Mumbai.

### National Securities Clearing Corporation

As stated earlier, trading in the securities market in the pre-reform phase was fraught with counterparty risks. Small counterparty risks could turn into large counterparty risks owing to cascading effects, jeopardising the functioning of the entire market. To tackle this problem, the National Securities Clearing Corporation (NSCC) was set up in 1996. Effective on July 4, 1996, the NSCC started guaranteeing all trades on NSE. "This means that when A and B make a trade, NSCC interposes itself between them. If A was supposed to buy from B, then NSCC buys from B and NSCC sells to A. If either A or B default, the NSCC still meets the obligation for the other leg of the trade. Thus every trade that takes place is freed from the risk of the counterparty defaulting. This automatically ends the risk of cascading failures generating a payments crisis."<sup>10</sup>

### Dematerialisation

The final leg of a transaction is where the title on a security is changed from the seller to the buyer. Since share certificates in India were printed on paper, trading in them was fraught with operational cost and risk. Theft or counterfeiting of share certificates gave rise to a number of criminal activities. To tackle this problem, National Securities Depository Limited (NSDL) was set up in November 1996. This was followed by the setting up of the Central Securities Depository Services (India) Ltd. (CSDL). The depository maintains a computer record of ownership of securities and dispenses with physical share certificates. This cuts down the hazards related with physical trading in share certificates and also reduces the transaction costs substantially. This form of trading is known as 'demat' (or 'dematerialised') trading. Most of the trading is now done in demat form. As on March 31, 2006, companies available for demat numbered 11,501. Total shares settled in demat were 6,563 crore and the value of demat amounted to Rs. 7,84,860 crore in 2005-06.<sup>11</sup>

NSDL has created three pioneering systems : SPEED-e, STeADY and IDeAS. SPEED-e allows users to execute delivery instructions using the Internet. STeADY constitutes Internet-based infrastructure for facilitating straight-through processing. IDeAS constitutes Internet-based facilities for end-users to view their depository holdings and transactions. However, as of now, these three systems are at a nascent stage and have only a limited usage.

The institutional changes effected in the Indian capital market in the post-reform phase (discussed above) and the various measures undertaken to strengthen the capital market<sup>12</sup> have undoubtedly helped the Indian capital market to grow strong in recent years. A significant feature of the primary market activity after abolition of capital controls was that the corporates attempted to diversify the range of instruments. A wide variety of innovative/hybrid instruments were introduced to suit varied needs of investors and issuers/borrowers. Some of

the instruments which became quite popular were Secured Premium Notes (SPN) with detachable warrants, non-convertible debentures with detachable equity warrants, zero-interest equity shares with detachable equity warrants, fully convertible cumulative redeemable preference shares, etc. However, the primary capital market witnessed distinctly depressed conditions for a period of three-four years commencing 1995-96. As noted earlier, resource mobilisation by private sector companies declined consecutively at an average annual rate of 48.1 per cent over the three year period 1995-96 to 1997-98. The resource mobilisation in 1997-98 was just Rs. 3,138 crore though it picked up somewhat in 1998-99 and 1999-2000. The poor resource mobilisation was basically due to lack of investor interest. With faltering performance, and low and uncertain returns in the capital market, the small investor nearly deserted the primary and secondary market. On the other hand, the Indian institutional investors were constrained by lack of funds. The only entities that had money power or effective purchasing power were the foreign institutional investors (FIIs). However, as noted by R.H.Patil, "The operations of the FIIs in India are often sporadic as their buy and sell decisions are governed by global strategies in which the Indian market continues to be a marginal player."<sup>13</sup>

The year 1999-2000 saw a revival of investor interest in the capital market. This is clear from the fact that the Initial Public Offers (IPOs) of most of the companies were oversubscribed heavily. This holds particularly true for companies related to information technology, telecommunications and entertainment — the so called *golden triangle*. The share price of companies related to these three sectors rose markedly in the secondary market as well. All this resulted in a substantial increase in the market capitalisation. In fact, the market capitalisation of all stocks listed on the Bombay Stock Exchange (BSE) rose to over Rs. 11,00,000 crore (about \$ 256 billion) on February 14, 2000, putting India among the world's top 10 markets by market capitalisation.<sup>14</sup>

The year 2000-01 was bad for the capital market. There was a steep decline in share prices (particularly of companies belonging to the 'golden triangle') with the result that there was a steep decline by more than 30 per cent in market capitalisation at BSE over the year 2000-01. Market capitalisation at the National Stock Exchange also fell by 35.5 per cent over the period.

The stock market scam discovered in March-April 2001 further dampened the spirits of the investors and the year 2001-02 turned out to be still worse for the capital market. A bearish sentiment prevailed in the stock market during 2001-02. Growing fears of a global slowdown, combined with report about stock market irregularities, adversely affected investors' confidence. As in the previous year, market capitalisation eroded both at the National Stock Exchange and the Bombay Stock Exchange. Capital market remained subdued in 2002-03 as well. This weakness in secondary market led to a small volume of issuance on the primary market. However, the year 2003-04 saw a revival. With good corporate earnings in 2003-04, the Sensex crossed 6,194 in January 2004. Market capitalisation on BSE rose to Rs. 9,60,514 crore in 2003-04 from Rs. 6,02,067 crore in 2002-03 (yearly average). Market capitalisation on NSE rose to Rs. 8,88,490 crore in 2003-04 from Rs. 6,16,537 crore in 2002-03 (yearly average). However, the stock market remained subdued during March-July 2004. The market sentiments improved considerably towards the end of 2004 mainly on account of sustained macroeconomic fundamentals, encouraging quarterly results of major corporates and strong investments by Foreign Institutional Investors (FIIs) in equities.<sup>15</sup> The domestic stock markets recorded substantial gains in 2006-07 and the process continues in the current financial year 2007-08 as well. For example, the BSE Sensex at end March 2007 increased by 15.9 per cent (year-on-year) on top of the increase of 73.7 per cent a year ago. Strong corporate profitability and continued liquidity support from FIIs (foreign institutional investors) and domestic mutual funds buoyed up the stock markets even as they witnessed sharp correction on a few occasions. During 2006-07, the BSE Sensex moved in a range of 8929 (June 14, 2006) and 14652 (February 8, 2006), before closing at 13072 on March 30, 2007. The market capitalisation of the BSE increased by 17.3 per cent during 2006-07 reflecting increase in stock prices as well as new listing of securities. The market capitalisation of the BSE, as per cent to GDP, rose from 84.7 per cent at end-March 2006 to 85.9 per cent at end-March 2007. Market capitalisation of BSE was Rs. 35,45,041 crore and that of NSE was Rs. 33,67,350 crore in 2006-07.<sup>16</sup> The domestic stock markets have recorded further gains in 2007-08 and the BSE Sensex touched the figure of 19,783.51 on October 31, 2007.

#### ■■■■■ NOTES ■■■■■

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