

**REPORT OF THE INFORMAL GROUP TO STUDY THE ROLE
OF BANK DEPOSITS IN SAVINGS MOBILISATION**

**RESERVE BANK OF INDIA,
MUMBAI
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ABBREVIATIONS

BSE	-	Bombay Stock Exchange
CBDT	-	Central Board of Direct Taxes
DFIs	-	Development Financial Institutions
GDP	-	Gross Domestic Product
GDS	-	Gross Domestic Savings
FIs	-	Financial Institutions
IDBI	-	Industrial Development Bank of India
IFCI	-	Industrial Finance Corporation of India
IVP	-	Indira Vikas Patra
KVP	-	Kisan Vikas Patra
LIC	-	Life Insurance Corporation of India
MFs	-	Mutual Funds
NABARD	-	National Bank for Agriculture and Rural Development
NCAER	-	National Council of Applied Economic Research
NSCs	-	National Savings Certificates
NBFCs	-	Non-Banking Financial Companies
NBNFCs	-	Non-Banking Non-Financial Companies
NHAI	-	National Highway Authority of India
PPF	-	Public Provident Fund
PSUs	-	Public Sector Undertakings
RBI	-	Reserve Bank of India
RNBCs	-	Residuary Non-banking Companies
SEBI	-	Securities and Exchange Board of India
UTI	-	Unit Trust of India

CHAPTER 1

INTRODUCTION

The economic reforms in general and the financial sector reforms in particular, initiated since the early 1990s have brought about significant structural and operational changes in the Indian financial system. Not only the number of institutions and the products offered by them have multiplied and diversified but the distinction between the institutions and instruments is also getting increasingly blurred. Consequent integration of different segments of the market has promoted the competitive forces among the financial intermediaries accessing savings of the public.

1.2 In this milieu of widening and deepening of the financial system, the role of the banks as the traditional mobiliser of savings has been increasingly challenged. The attractiveness of bank deposits as a means of saving has, perhaps, tended to be diluted. Since the banking sector continues to be the most important financial intermediary, the possibility of their resource base erosion is a matter of concern to the Reserve Bank.

1.3 Against this background, it was thought desirable to study the impact of increased competition among the financial intermediaries on the resource mobilisation by the banking sector, and to analyse the attractiveness of bank deposits vis-a-vis other forms of savings in terms of liquidity, safety, convenience, etc. For this purpose, the Reserve Bank constituted an Informal Group to Study the Role of Bank Deposits in Savings Mobilisation with the following members:

1. Shri A.P. Kurien - Member,
Chairman,
Association of Mutual Funds in India,
Mumbai.
2. Dr. Ajay Shah – Member¹,
Professor,
Indira Gandhi Institute of Development Research,
Mumbai.

¹ Dr. Ajay Shah did not attend any meeting. He also did not offer any comment on the papers and the Report circulated among the members.

3. Dr. P.P. Shastri - Member,
Executive Assistant to Chairman,
Unit Trust of India,
Mumbai.
4. Shri Kevin Desouza - Member,
General Manager (Accounts & Finance),
The Stock Exchange, Mumbai,
Mumbai.
5. Shri Mahesh Thakkar - Member,
Executive Director,
Association of Leasing and Financial Services,
Mumbai.
6. Dr. N. Nagarajan - Member,
Adviser,
Department of Economic Analysis & Policy,
Reserve Bank of India,
Mumbai.
7. Dr. G.S. Bhati - Member,
Adviser,
Monetary Policy Department,
Reserve Bank of India,
Mumbai.
8. Dr. D.V.S. Sastry - Member,
Director,
Monetary Policy Department,
Reserve Bank of India,
Mumbai.
9. Dr. Janak Raj - Convenor,
Director,
Capital Market Division,
Department of Economic Analysis & Policy,
Reserve Bank of India,
Mumbai.

1.4 The remit to the Group was to look into the various aspects of resource mobilisation by banks and other financial institutions. The Group was asked to submit the Report by the end of June 2000. The Memorandum appointing the Group is at Annexure I.

Meetings of the Group

1.5 The Group in all held four meetings at Mumbai. The Group unanimously elected Shri A.P. Kurien as the Chairman of the Group at the first meeting.

Acknowledgements

1.6 The Group acknowledges the excellent secretarial support provided by the Capital Market Division of the Department of Economic Analysis and Policy of the Reserve Bank of India. In particular, the Group expresses its gratitude to S/Shri Rajib Das, Anand Prakash, Anamitra Saha, S.S. Iyer and S. Ranadive for providing valuable help in collecting necessary data and information required for preparing the Report. The Group also thanks Mrs. S. Varghese who bore the brunt of word processing the Report.

Outline of the Report

1.7 As the reforms in the financial sector were initiated during the early 1990s, the Group decided to analyse the trends in various saving instruments from 1990-91 to 1998-99/1999-2000 depending on the availability of data. As the terms of reference were very broad, the Group thought it appropriate to confine its analysis to the following aspects:

- (i) the relative attractiveness of various saving instruments in terms of returns, liquidity and tax incentives;
- (ii) movement of interest rates on various saving instruments; and
- (iii) movements in bank deposits in general and term deposits in particular *vis-a-vis* other saving instruments.

1.8 The study is organised in 5 Chapters. Chapter 2 presents some theoretical perspectives on asset allocation behaviour of the investor. Chapter 3 analyses in detail the characteristics of various savings instruments in terms of return, liquidity and tax incentives as they evolved during the 1990s. Chapter 4 analyses the trends in the growth rates of various saving instruments since 1990-91. Chapter 5 summarises the main findings of the study and presents some final reflections.

CHAPTER 2

ASSET ALLOCATION - THEORETICAL PERSPECTIVES

2.1 There are various instruments in which the general public deploy their savings, such as, bank deposits, shares, debentures, units of mutual funds, insurance policies, etc. Allocation of financial savings among these instruments is influenced broadly by two factors, *viz.*, availability of financial instruments and the nature of investment objective. Both these factors, in turn, are closely associated with the level of economic and financial development. For instance, demand for insurance tends to be higher in developed economies. Also, at a higher level of income, asset-owners have greater ability to undertake risky investments, such as, in equities. Besides the level of economic activity, institutional factors also influence the process of asset allocation in significant ways.

2.2 In an environment where certainty prevails, the decision to invest boils down to selecting that instrument which yields highest return. If returns on financial assets are uncertain, the choice of allocation among alternative financial instruments depends upon the investors' perceived or expected return on individual assets and some measure of risk or variability in the return². The returns from the instruments are also expected to bear a positive or negative correlation among them depending upon their mutual complementarity and substitutability. In an uncertain situation, in general, allocation of financial wealth in more than one financial asset, rather than only in one asset promising highest return, becomes a rational response of risk averse investors. This is because assets which promise high return on the average, are also found to have high variability in their returns. Allocation of wealth in more than one asset (portfolio investment) or hedging typically reduces the variability in the overall return.

2.3 Any portfolio of investment consists of three broad classes of financial assets, *viz.*, debt (bonds or debentures or fixed income instruments), equities, and cash

² In investment management, risk is often equated with the uncertainty (variability measured in standard deviation) of possible returns around the expected return. A common investor, however, does not typically think in terms of expected return and standard deviation. He thinks of risk in terms of the 'chance of loss' of his investment.

(including money market instruments). Cash is the safest and most liquid asset but has lowest return. Return on bond/debenture/other fixed income instruments depends on its price and the coupon/discount/interest rate. The average return on equities is generally higher than the average return on bonds but the former also displays greater volatility.

2.4 Initially, security analysis was a time-dimensional process focussing on the risk/return characteristics of individual securities. The Portfolio Theory added a third dimension to this process which evaluates the effect of diversification of investment in different instruments on a portfolio. Diversification effect considers the impact of the inclusion of a particular asset class or security on both volatility and return characteristics of the overall portfolio. In an efficient capital market, security prices are always fair. Given this assumption, the Portfolio Theory stresses that it is wise to simply 'buy and hold' a broad array of diverse investments.

2.5 Modern Portfolio Theory (MPT) has redefined the notion of diversification. Traditionally, diversification is based on the idea that it is better to avoid putting all eggs in one basket. The MPT has gone beyond the idea and suggested using a large number of baskets in which to carry one's eggs. It has also suggested that major emphasis must also be placed on finding baskets that are distinctly different from one another so that each basket's unique pattern of return partially offsets that of others, thereby smoothening the overall volatility of the portfolio.

2.6 The portfolio selection models, of which expected utility approach and mean-variance approach are two major variants, form the theoretical basis of asset allocation. In the expected utility approach, the expected utility of the investor depends on the random returns from alternative financial assets held by the investor. The investor allocates his wealth in alternative financial assets to maximise the expected utility subject to various constraints reflecting his budget, requirement of liquidity, institutional restrictions etc.

2.7 The alternative is mean-variance approach to portfolio selection indicated by Markowitz (1952)³. The essence of the mean-variance model is, *ceteris paribus*, more

³ Markowitz, Harry M. (1952): "Portfolio Selection", *Journal of Finance*, March.

expected return is preferred to less return and less variance is preferred to more. This has become the dominant position in much of the empirical studies and practice.

2.8 Both individual and institutional investors restrict their asset allocation depending on their investment horizon, appetite for risk, requirement of liquidity, unique needs and tax considerations. For example, insurance and pension funds typically have long term liabilities so that their proportion of investment in long-term securities would be generally higher. Banks, on the other hand, have shorter investment horizon. Again, the requirement of liquidity⁴ is high for banks and mutual funds. Tax considerations influence the asset allocation of taxable entities in significant ways. For example, the optimal mix of the debt and equity would depend on how interest income is taxed *vis-a-vis* dividend and capital gains. Differential tax treatment of dividend and capital gains also makes the corporate dividend policy an important determinant of the asset allocation. Special tax treatments are often used by the policy makers to encourage investments in particular financial instruments, such as, mutual funds. They are also used to develop markets in the long term instruments (e.g., infrastructure bonds).

2.9 Investors' attitude towards financial risks has overwhelming importance in asset allocation. Attitude towards risk differs significantly among financial institutions as also across individual investors. Mutual funds may undertake risky investments in equities under their growth schemes, while under their income schemes they would choose relatively safe investments. A critical determinant of optimal asset allocation for individuals is the time and their risk profile. Generally, it is optimal to start with a high proportion of one's investment portfolio in stocks and decrease it over time in favour of bonds. Asset allocation of individuals is also conditioned by individuals' unique needs, such as, higher education and marriage of children, retirement date for a wage earner. Risk tolerance also differs among individuals. Hence, some leading fund managers explicitly or implicitly try to classify their clients, whose funds they manage, into various risk tolerance categories for which different mix of assets are offered.

⁴ Liquidity is the ease (speed) at which an asset can be sold and still fetch a fair price. It is a relationship between the time dimension (how long will it take to dispose) and the price dimension (any discount from fair market price) of an investment asset.

2.10 For many investors, tax consequences are central to investment decisions. The performance of any investment strategy is improved on the basis of its post-tax-yields. For investors, who face significantly higher tax rates, tax sheltering and deferral of tax obligations may be pivotal in their investment decisions.

2.11 Another consideration that also influences asset allocation decision is to hedge against inflation. The real return on fixed income securities is often eroded with inflation. In many countries, governments float bonds for which both principal and interest are linked to inflation. They offer suitable investment instruments for retired persons, who want to maintain a real consumption level during their retired life time. To the extent interest rates are correlated to inflation rate, floating rate bonds provide a hedge against inflation. It is often argued that equities offer a hedge against inflation. This is, however, doubtful, as it implies that the real rate of profit of corporates would be independent of the rate of inflation. For example, the experience in the USA suggests that the returns on stocks were negatively correlated with the rate of inflation in the past although the degree of correlation is small (Zvi Bodie, 1976)⁵. While it is true that in the long-run equities may have a higher rate of return than, say, bonds, it does not necessarily imply that the high returns would effectively hedge against inflation.

⁵ Zvi Bodie (1976): 'Common Stocks as a Hedge against Inflation', *Journal of Finance*, May.

CHAPTER 3

FEATURES OF VARIOUS SAVINGS INSTRUMENTS AS EVOLVED DURING THE 1990s

3.1 Various features of the saving instruments, such as, risk-return profile, liquidity, tax benefits, etc. undergo changes over a period of time either as a result of regulatory changes or due to competitive forces. It is, therefore, necessary to review the major features of the various instruments and the changes that occurred in them year after year, as also the new instruments which emerged on the scene. The developments relating to these features during the 1990s are discussed in this Chapter.

3.2 Savers in India have traditionally enjoyed many choices for deploying their investible funds. Apart from bank deposits, which have been the most preferred form of savings, there has been a wide variety of other savings instruments, such as, life insurance policies, small savings (post office deposits, saving certificates, public provident fund), units of UTI, shares and corporate debentures and deposits with companies, both in the financial and non-financial sector. With the setting up of bank-sponsored and FI-sponsored mutual funds and many public sector undertakings issuing both taxable and tax free bonds in the second half of 1980s, the instruments available to savers increased further. During the 1990s, the savers' choice for instruments widened considerably on account of, *inter alia*, the following factors:

- i) Mutual funds made rapid strides. As against 15 schemes in operation till end-June 1987 by one mutual fund, i.e., UTI, the total number of schemes launched reached 89 by eight MFs (48 by bank and FI - sponsored MFs and 41 by UTI) by end-June 1992. With the granting of permission to the private sector to set up mutual funds, the trend accelerated further. By end-March 2000, there were as many as 330 schemes in operation by all mutual funds. Some were growth-oriented, some income-oriented and some were balanced schemes. Besides, sector specific schemes were introduced.
- ii) Development financial institutions (DFIs), such as IDBI, ICICI and IFCI began to access the bond market frequently for their fund requirements following the drying of concessional finance from the Reserve Bank and the

Government. To meet the requirement of the investors, they issued instruments with many innovative features which also suited their own needs.

- iii) The NBFCs grew at a rapid rate during the early period of reform, both in number and size, and they offered attractive rates of return and other incentives.

3.3 Developments during the 1990s having a bearing on the attractiveness of various saving instruments in terms of return, liquidity and tax benefits are discussed below.

Bank Deposits

3.4 Bank deposits are considered very safe for several reasons, such as, closer supervision and monitoring of operations of banks by the Reserve Bank, an element of an insurance (all deposits are insured subject to a limit of Rs.1 lakh per individual), and public sector character of some banks.

3.5 With a view to enabling banks to compete effectively with other financial intermediaries, some significant relaxations were made. Interest rates on bank deposits were gradually freed. Banks now have complete freedom to determine the interest rates on domestic term deposits. They are also allowed to offer floating rate of interest on their deposits. Besides, the restriction on banks that they must offer the same rate of interest on deposits of the same maturity irrespective of the size of such deposits was removed in respect of deposits of Rs.15 lakh and above. Furthermore, banks were allowed to determine penalty for premature withdrawal of domestic term deposits. In respect of term deposits, the minimum period of maturity of term deposits was reduced gradually from 45 days to 15 days.

3.6 Term deposits with banks are now available for a maturity ranging from 15 days and up to 5 years. Bank deposits are very liquid. Loan up to 75 per cent of the deposit can be obtained from banks against fixed deposit receipts. Premature withdrawals are also allowed. Apart from safety and liquidity, banks offer extraordinary transaction convenience to savers through their wide branch network.

3.7 Bank deposits do not enjoy any tax rebate. However, interest from deposits, along with some other specified instruments, up to Rs.12,000 is free from tax under Section 80L of the Income Tax Act. From the year 1995-96, interest earnings exceeding Rs.10,000 per annum are subject to deduction for tax at source at the rate of 10 per cent for individuals and 20 per cent for corporates. From the year 1993-94, bank deposits are totally exempted from wealth tax.

LIC Policies

3.8 The LIC policies combine the elements of insurance and savings. Life insurance policies are mainly of five types, viz., whole-life policies, endowment policies, joint life policies, children's policies and annual plans. During the 1990s, LIC introduced a wide variety of insurance policies to meet insurer's needs. An important development during the 1990s impinging on the return to policy holders was the change, effected in November 1997 in the investment guidelines for the LIC. The revised guidelines allowed the LIC the discretion to change the portfolio, depending on the market conditions, in respect of 25 per cent of accretions to the 'Controlled Fund' (after investing 75 per cent in the approved securities), while earlier it was required to deploy such accretions in fixed proportions for specified purposes.

3.9 Insofar as tax benefits on the LIC policies are concerned, some of the schemes, such as, pension schemes like Jeevan Sarita, enjoy tax benefit under Section 80CCC of the Income Tax Act whereby premia paid is allowed to be deducted from the income. Some schemes, such as, money back, whole life, and endowment policies, enjoy tax benefits at a uniform rate of 20 per cent tax rebate under Section 88 of the Income Tax Act. Anticipated policies, which are insurance against certain diseases, however, do not enjoy any tax rebate. However, maturity proceeds in respect of all the LIC policies are totally exempted from tax under Section 10 of the Income Tax Act.

3.10 There is a facility for surrendering the policy before maturity. If the insurer surrenders the policy, the LIC pays a specified amount as the surrender value. It is also possible to take a loan from the LIC under its various schemes.

Small Savings Schemes

3.11 Small savings schemes commonly referred to are post office deposits (savings bank deposits, time deposits, recurring deposits, and monthly income scheme), certificates issued by the Government (National Savings Certificates VIII, Indira Vikas Patra, and Kisan Vikas Patra), National Savings Scheme 1992, and the Public Provident Fund. All these small savings schemes are operated either directly by the Government through post offices or nationalised banks and are, therefore, considered very safe.

3.12 All small savings schemes, barring IVP and KVP, enjoy tax benefits. All post office deposits enjoy tax benefits under Section 80L of the Income Tax Act. The National Savings Scheme (NSS) earlier enjoyed exemption under Section 80CCA whereby amount deposited could be deducted from income. This Section (80CCA) was withdrawn from the year 1992-93. Instead, investments under NSS were included in Section 88, which provides for a uniform 20 per cent tax rebate. The IVP and KVP, which do not enjoy any tax benefits, carry attractive rates of interest. The Public Provident Fund (PPF), in which the maximum permissible investment is Rs.60,000 in a fiscal year, enjoys tax rebate at the rate of 20 per cent under Section 88. Besides, the entire interest earned under PPF is tax free under Section 10 of the Income Tax Act.

3.13 The maturity of the small savings schemes ranges from 1 year to 15 years. Most of the post office deposit schemes have a provision for premature withdrawal. The PPF and NSC have, however, limited liquidity. The NSCs can not be encashed before maturity. They are also not tradable but collateralable in that the investor has the option of pledging NSCs to raise loans from banks. In the case of PPF, withdrawals are possible only in the seventh year after commencement of the deposit.

Units of Mutual Funds

3.14 Although the first mutual fund scheme was launched in 1964, it was in the late 1980s and the early 1990s that units gained wide popularity. To suit the varied investor's needs, mutual funds have launched equity or growth oriented, debt or

income oriented, and balanced schemes. Sector specific schemes, liquid funds, index funds, etc. have also been launched. Some mutual funds, especially UTI, operate monthly income schemes which have also become quite popular.

3.15 Mutual fund schemes are broadly of two types, i.e., open-ended and close-ended. In case of open ended schemes, mutual funds stand ready to buy and sell any quantity of units at NAV related prices. Thus, open-ended schemes are quite liquid. On the other hand, close ended schemes are open for subscription only for specific period. The units under this type of scheme are listed on the stock exchanges. However, there is limited trading in them. Also, many of the schemes are being quoted at discount, i.e., at a price, which is lower than their NAV, which, in turn, has affected their liquidity.

3.16 Many mutual funds, especially bank-sponsored and FI-sponsored, had offered assured return schemes, which became quite popular. However, owing to market conditions, some of them were unable to honour their commitment and hence had to be bailed out by their sponsors. Of late, the trend towards floating assured returns schemes is waning and there are very few schemes now on which the return is assured.

3.17 As regards tax benefits on units of mutual funds, earlier, only ULIP-7i, which is operated by UTI in collaboration with LIC and GIC, enjoyed tax rebate. During 1990-91, investments in equity linked saving schemes of UTI and other mutual funds were allowed to be deducted from total income up to a maximum of Rs.10,000 under Section 80CCB. From the year 1992-93, investments up to maximum limit of Rs.10,000 in such schemes are allowed tax rebate under Section 88.

3.18 Traditionally, the income from units of mutual funds enjoyed tax benefit under Section 80L. From the year 1990-91, an exclusive exemption of Rs.3,000 was also made available for income from investments in mutual funds, including UTI. From the year 1998-99, income from mutual funds, including units of UTI, was totally exempted at the hands of investors, while mutual funds themselves were required to pay a tax at the rate of 10 per cent which was raised later to 20 per cent from the year 1999-2000 in respect of debt oriented schemes. However, equity oriented schemes,

where 50 per cent or more funds are invested in equities, were exempted from the payment of tax for a period of three years from 1999-2000 to 2001-2002. From 1996-97 to 1999-2000, long term capital gains were exempted from capital gains tax if invested in specified securities, including units of mutual funds.

Company Deposits

3.19 Both the financial and non-financial companies are permitted to raise deposits. While deposits mobilised by the non-banking non-financial companies are governed by the provisions of Section 58A of the Companies Act, those by the financial companies are governed by the guidelines issued by RBI under the Reserve Bank of India Act.

3.20 The interest rates on deposits of NBFCs, which were regulated, were freed in 1996 for registered, rated and those which complied with the prudential norms prescribed by RBI; this freedom was withdrawn with effect from January 2, 1998. For all other categories, a ceiling of 15 per cent continued.

3.21 Presently, for all NBFCs other than chit fund companies and RNBCs, there is an interest rate ceiling of 16 per cent. The RNBCs are governed by a floor level rate of interest (not less than 8 per cent per annum for term deposits with instalments receivable on other than daily basis and not less than 6 per cent per annum on daily deposits). In respect of deposits of NBNFC, the ceiling is 15 per cent. Besides, companies are also allowed to pay brokerage up to 2 percentage points.

3.22 The NBNFCs are allowed to raise deposits for a maximum period of 36 months and for a period of not less than six months. However, to meet short-term requirement of funds, a company can raise deposits for maturity of less than six months but not less than 3 months.

3.23 The NBFCs can raise deposits for a maturity ranging from 1 year to 5 years. Premature withdrawals by depositors in respect of any category of company are not allowed for less than 3 months. Premature withdrawals for other periods are allowed

with some penal interest. Deposits with companies and the interest earned thereon do not enjoy any tax benefits.

Capital Market Instruments (Excluding Units of Mutual Funds)

Shares

3.24 Though stock markets in India existed for more than 100 years, it was only during the 1980s, that there was a sharp rise in the investor population in stock markets. In the 1990s, despite two major developments, viz., free pricing and the abolition of double taxation, investors' interest, both in the primary and secondary markets, remained generally lukewarm due mainly to depressed stock market conditions. Though shares are expected to be liquid, most of them are not really so. This is evident from the fact that 90 per cent of the trading at BSE is concentrated in top few scrips, although more than 6,500 scrips are listed.

3.25 Insofar as tax benefits on investment in shares are concerned, investments up to Rs.25,000 in eligible shares of companies, notified by the CBDT, were allowed deduction. During the year 1990-91, Section 88A was introduced, which allowed an additional rebate of 20 per cent with a maximum ceiling of Rs.5,000 for investment in equity shares, units of mutual funds, etc. From the year 1994-95, Section 88A was omitted and the exemption on eligible issues, along with other specified savings for the purposes of income tax, was included under Section 88. Investments in the listed shares are subject to capital gains tax. However, from the year 1993-94, indexation on capital gains was introduced. From 1994-95, the shares, if held for more than 12 months, are treated as long-term capital asset (as against 36 months earlier) and thus attract a lower rate of capital gains tax. In the Union Budget for 1999-2000, dividend received at the hands of investors was fully exempted from income tax, while companies were required to pay tax at a flat rate of 10 per cent which was later increased to 20 per cent from the year 2000-2001.

Corporate debentures

3.26 Corporate debentures in India, which initially existed in the pure form, i.e., non-convertible, witnessed many innovative features in the 1990s. They were

introduced in various forms, such as, fully convertible debentures, secured premium notes with detachable warrants, debentures with detachable equity warrants, etc. Debentures in India, which became quite popular in the 1980s and early 1990s, have since declined in their importance and most of the debentures being issued now carry equity features in some form or the other.

3.27 Interest rate on debentures, which was regulated earlier, was freed in August 1991. The maturity period of debentures normally ranges from 1 to 7 years. Debentures are fully secured. Debentures are normally listed on stock exchanges to provide liquidity. However, there is not much trading in them.

3.28 There are two schemes for payment of interest. In the cumulative scheme, interest is compounded at half yearly intervals and paid along with principal. In the non-cumulative scheme, interest paid usually at half yearly intervals and in some cases at quarterly interval. This method is attractive for people who want a steady income over a period of time.

3.29 Investments in debentures do not enjoy any tax rebate. Interest earned from them is fully taxable.

3.30 All debentures, irrespective of the maturity period, are now required to be mandatorily rated by a credit rating agency. Earlier, rating on debentures with less than 18 months maturity was not mandatory.

Bonds of PSUs and DFIs

3.31 During the late 1980s, several public sector undertakings started raising resources through the issue of bonds. These public sector bonds were essentially of two types, viz., taxable and tax free. In August 1991, along with corporate debentures, interest rate on PSU bonds, other than tax free bonds, was freed.

3.32 In the 1990s, bonds issued by DFIs emerged as a popular avenue for investment. The DFIs issued bonds with many innovative features to suit investors' needs. The maturity period of bonds varied from 1 year to 15 years with in-built put and call options.

3.33 The interest rates on DFI bonds, which were earlier free, were regulated in March 1998 when RBI stipulated that all bonds with maturity of more than 5 years and above and carrying interest rate more than 200 basis points above the yield on the Government of India securities of equal residual maturity should be submitted to it for approval. In terms of the revised guidelines prescribed in June 2000, DFIs now are not required to seek RBI's prior approval. This is, *inter alia*, subject to the condition that the minimum maturity of the bond is 3 years and that yield to maturity (YTM) offered at the time of issue of bonds does not exceed 200 basis points above the YTM on the Government of India securities of equal residual maturities.

3.34 The bonds issued by DFIs are normally unsecured and do not enjoy any tax benefits, except those bonds whose proceeds are intended to be deployed towards infrastructure projects (infrastructure bonds). The Infrastructure bonds were earlier allowed tax rebate up to a maximum amount of Rs.70,000 (increased to Rs.80,000 from the year 2000-2001) under Section 88 or exemption from tax on capital gains arising from the transfer of long term capital assets under Sections 54EA/54EB. However, with the withdrawal of benefits under Sections 54EA/54EB in the Union Budget 2000-2001, tax benefits for infrastructure bonds of DFIs are now available only under section 88.

3.35 The DFIs are also allowed to raise term deposits within the stipulated limits in a maturity range of 1 to 5 years. The rate of interest to be offered by DFIs on term deposits was subject to a ceiling of 14 per cent per annum with an added stipulation that in any case, interest rate offered would not exceed the rate offered by State Bank of India on the corresponding maturities. However, recently, these restrictions have been removed and DFIs have been given the freedom to fix interest rates on their term deposits.

3.36 Tax benefits available on various savings instruments are presented in Table 1, while section-wise details of various tax benefits are set out in Annexure II.

Table 1: Tax Benefits under various Sections of the Income Tax Act - As on March 31, 2000

Instrument	Exemption of Income – interest and dividend		Exemption from capital gains tax		Tax Rebate *
	Total exemption \$\$ (u/s 10)	Partial Exemption upto a limit @@ (u/s 80L)	Short-term	Long-term # (u/s 54EA, 54EB and 54EC)	Section 88
1. Bank Deposits	-	Rs.12,000	-	-	-
2. Mutual Funds	✓ \$\$	-	-	-	✓ @
3. LIC Policies	✓ \$\$	-	-	-	✓
4. Bonds by Fis	-	-	-	✓ #	✓ \$
5. Shares	✓ \$\$	-	-	-	✓ \$
6. Debentures of Companies	-	-	-	-	✓ \$
7. Small Savings	-	-	-	-	-
a) Post Office Deposits	-	Rs.12,000	-	-	-
b) Certificates VIII Issue ##	-	Rs.12,000	-	-	✓
c) Approved Provident Funds including P.P.F.	✓ \$\$	-	-	-	✓
d) National Savings Scheme, 1992	-	Rs.12,000	-	-	✓
8. Company deposits	-	-	-	-	-
a) NBFCs	-	-	-	-	-
b) NBNFCs	-	-	-	-	-

✓ Exemptions and tax rebate available.

Exemptions and tax rebate not available.

Income from long-term capital asset (if held for more than 12 months) is taxed at a flat rate 20 per cent after indexation (10 per cent without indexation). Exemption from long-term capital gains were available under section 54EA and 54EB where the investor was willing to block the funds generated from sale of long-term assets in specified securities. However, exemptions under Section 54EA and 54EB were withdrawn in the Union Budget 2000-2001 and a new Section 54EC was introduced, whereby tax exemption on long-term capital gains is now available only if the gain are invested in specified long-term assets, i.e., bonds issued by the NABARD or the NHAI that are redeemable after three years.

Available only for National Savings Certificate (NSCs). No tax rebate is available on Indira Vikas Patra and Kisan Vikas Patra. In respect of NSC VIII issue, though the investor gets a rebate on the original investment as well as subsequent interest earned u/s 88 of I.T. Act, the interest income received every year is not exempt under Section 80L of the I.T. Act and is taxable under the head "income from other sources".

@ Any unit linked insurance plan of UTI and LIC Mutual Fund and contribution to equity linked saving scheme of any mutual fund subject to a maximum of Rs.10,000/-.

@@ Though partial tax exemption upto Rs.12,000/- is available individually with respect to item 1, 7(a), 7(b) and 7(d) an investor cannot claim an exemption of more than Rs.12,000/- on an aggregate even if he invested in more than one of these instruments.

\$ Equity shares, debentures of a public company engaged in infrastructure (including power sector) only and bonds of FIs if proceeds thereof are intended to be deployed for infrastructure projects only.

\$\$ Maturity proceeds including income by way of interest in approved provident funds including P.P.F. and bonus in case of insurance policies are exempt from tax as capitalised income under section 10 of I.T. Act, 1961. Dividend income from shares of companies and units of mutual funds are also exempt u/s 10 of the Income-tax Act.

* Tax rebate is available under Section 88 of the Income-tax Act, 1961. The maximum amount of rebate available is Rs.12,000/- (i.e. 20 per cent of Rs.60,000/-). By investing in shares or debentures of infrastructure sector, a higher qualifying amount of Rs.80,000 and a tax rebate of Rs.16,000/- (i.e. 20 per cent of Rs.80,000/-) can be claimed. By investing only in shares/debentures of an infrastructure company and bonds of FIs if proceeds thereof are intended to be deployed for infrastructure projects, maximum rebate of Rs.16,000/- (i.e. 20 per cent of Rs.80,000/-) may be claimed.

Rate of Return on Alternative Saving Instruments

3.37 Rate of return is the single most important factor influencing the portfolio behaviour of investors, *ceteris paribus*. It, therefore, becomes necessary to analyse the trends in interest rates available on various saving instruments to assess their attractiveness.

3.38 An analysis of rate of return on various saving instruments during the 1990s (Table 2) reveals that the interest rate on term deposits of commercial banks in general tended to move downwards. The interest rate on term deposits with maturity 1 to 3 years moved down from 12.0 per cent during 1991-92 to 8-10 per cent during 1999-2000. The interest rate on term deposits with over 3 years maturity moved down from 13.0 per cent to 10.0-10.5 per cent during the same period. Thus, between 1991-92 and 1999-2000, the interest rates were down by 2-4 percentage points on term deposits with 1 to 3 year maturity and 2.5-3 per cent with maturity over 3 years.

3.39 The interest rates on the post office deposits moved generally in tandem with the interest rates on term deposits with the commercial banks. While the interest rates on post office time deposits and recurring deposits were found to be either on par with term deposits of commercial banks or somewhat higher, the interest rates on post office monthly income scheme were generally found to be somewhat higher (50 basis points) than the interest rates on term deposits with maturity of 3 years and above of scheduled commercial banks. The interest rates on KVPs were found to be higher in the range of 0.75 to 3 per cent than the interest rates on term deposits. The interest rates on PPF and NSC VIII issue were found to be relatively sticky. However, the interests rates on these instruments, barring a few years, were found to be somewhat higher than the interest rates on bank deposits.

3.40 The interest rates on deposits with NBNFCs were also found to be generally moving in tandem with the interest rates on deposits with scheduled commercial banks. However, their interest rates were found to be normally 1.5 to 4 per cent higher than the deposits of comparable maturity with scheduled commercial banks. The interest rates in respect of deposits with NBFCs also moved in line with the

interest rates offered on bank deposits. However, in case of NBFCs, the interest rates were normally higher in the range of 1 to 5.5 per cent.

3.41 An analysis of interest rates on corporates debentures also suggests that such rates were quite flexible and moved up and down depending on the general structure of interest rates although it is difficult to establish their year-to-year relationship with bank deposits as was observed in case of company deposits. This could be attributed to the fact that the interest rates offered on debentures depend on the credit rating which varies from instrument to instrument and from borrower to borrower.

3.42 The DFIs have been raising term deposits from the early 1990s. The interest rates offered by DFIs on their term deposits moved quite in line with the interest rates offered by commercial banks on term deposits. This was due mainly to the reason that, until recently, interest rates by DFIs on their term deposits were subject to a ceiling in some form or the other.

3.43 As regards other instruments, LIC maintained generally a steady rate of return on its policies during the period from 1991 to 1999-2000 with the rate of return varying between 7 and 8 per cent.

3.44 Rates of return on equity shares and units of mutual funds varied sharply from year-to-year depending on the performance of the stock market and they did not bear any relation to the interest rates on other fixed income instruments.

3.45 It may be observed from the above analysis that interest rates on various non-banking saving instruments moved generally in line with the interest rates on term deposits of scheduled commercial banks. Even interest rates on small savings, which are administered, moved in line with the interest rates on term deposits of banks. It may also be noted that, after banks were given freedom to determine their own interest rates, the interest rate declined gradually from 11-13 per cent during 1996-97 to 8-10.5 by 1999-2000. Along with the decline in these rates, the interest rates on small savings, company deposits and debentures and DFIs deposits also declined. However, it is significant to note that, while, in general, the direction of the movement of interest rates on all these instruments was in line with the interest rates on term



Table 2: Trends in Interest Rates Available on Alternative Saving Instruments (Contd.)

Year (April - March)	Scheduled Commercial Banks			Company Deposits						Stock Market Yield#		(Per cent per annum) UTI's Unit Scheme-1964@	
	Deposit Rates			Non-Banking Non-Financial Companies			Non-Banking Financial Companies ###			(BSE SENSEX)		Dividend Rate	Yield
	1 to 3 years	Over 3 yrs. & upto 5 yrs	Above 5 yrs.	1 year	2 year	3 year	Less than 1 Year	1 Year to Less than 3 Years	More than 3 Years	1 year	5 year		
	1	2	3	4	5	6	7	8	9	10	11	12	13
1990-91	9.00-10.00	11.00	11.00	10.50-14.00	1200-14.00	13.50-14.00	-	-	-	65.94	13.63	19.50	14.03
1991-92	12.00	13.00	13.00	10.50-15.00	1200-15.00	1400-15.00	-	-	-	117.21	36.47	25.00	16.40
1992-93	11.00	11.00	11.00	1200-15.00	1300-15.00	15.00	-	-	-	31.99	40.11	26.00	19.06
1993-94	10.00	10.00	10.00	1200-14.00	13.00-14.00	14.00	14.00	14.00	14.00	-10.98	32.59	26.00	17.68
1994-95	11.00	10.00	11.00	13.00-14.00	1400-15.00	1400-15.00	10.00-15.00	14.00-15.00	14.00-15.00	40.40	35.54	26.00	16.33
1995-96	12.00	13.00*	13.00*	1200-15.00	1300-15.00	1400-15.00	10.00-15.00	13.20-15.00	13.20-15.00	-19.31	20.58	20.00	12.66
1996-97	11.00-12.00*	12.00-13.00*	12.50-13.00*	1300-15.00	1400-15.00	15.00	10.00-15.00	13.37-15.00	13.37-15.00	5.97	4.26	20.00	13.95
1997-98	10.50-11.00*	11.50-12.00*	11.50-12.00*	9.00-15.00	10.50-15.00	11.50-15.00	10.00-15.00	11.50-15.00	12.00-15.00	3.89	-2.45	20.00	13.85
1998-99	9.00-11.00*	10.50-11.50*	10.50-11.50*	10.00-15.00	11.5-15.00	13.00-15.00	10.00-16.00	12.00-16.00	12.96 -16.00	-20.40	-4.43	13.50	9.46
1999-00	8.00-10.00*	10.00-10.50*	10.00-10.50*	9.00-16.00	10.00-16.00	13.00-15.00	10.00-16.00	11.00-16.00	11.66-16.00	42.60	-	13.75	10.19

Table 2: Trends in Interest Rates Available on Alternative Saving Instruments (Concl.)

Year (April - March)	Small Savings Schemes##								Average rate of Returns on LIC Policies**	Corporate Debentures\$				Development Financial Institutions\$\$	
	Post Office Savings Bank Account	Post Office Time Deposit Account	Post Office Recurring Deposit Account	Post Office Monthly Income Scheme	PPF	National Savings Scheme, 1992	NSC VIII Issue	KVP		Less than 1 year	1 to 2 years	Over 2 yrs. & upto 5 yrs	Above 5 yrs.	1 to 3 years	Over 3 yrs. & upto 5 yrs
	15	16	17	18	19	20	21	22		23	24	25	26	27	28
1990-91	5.5	9.5-11.0	11	-	12	11	12	13.43	7.59	-	-	-	-	-	-
1991-92	5.5	9.5-11.5	11.5	12.0	12.0	11.0	12	13.43	7.52	(-)	(-)	(-)	(-)	-	-
1992-93	5.5	12.0-13.5	13.5	14.0	12.0	11.0	12	14.87	7.66	(-)	(-)	(14.5)	(16.3)	-	13.8
1993-94	5.5	10.5-12.5	12.5	13.0	12.0	11.0	12	13.43	9.46	-	16.5	15.0	14.5-19.3	-	13.3
1994-95	5.5	10.5-12.5	12.5	13.0	12.0	11.0	12	13.43	8.84	(-)	(-)	14.49	13.5-18.5	-	11.1
1995-96	5.5	10.5-12.5	12.5	13.0	12.0	11.0	12	13.43	7.78	(-)	5.1-21.0	(14.49)	12.4-16.0	-	13.8
1996-97	5.5	10.5-12.5	12.5	13.0	12.0	11.0	12	13.43	7.36	(-)	(15.6)	(-)	(12.8)	-	13.8
1997-98	5.5	10.5-12.5	12.5	13.0	12.0	11.0	12	13.43	7.52	5.1-20.5	14.5-22.7	14.5-21.6	14.5-21.0	-	13.8
1998-99	4.5	9.0-11.5	11.5	12.0	12.0	11.0	11.83	12.25	7.39	(17.1)	(18.4)	(16.3)	(17.6)	11.3	11.3
1999-00	4.5	8.0-10.5	10.5	11.0	11.0	10.5	11	11.25	7.15	(14.75)	(14.62)	(15.24)	(14.48)	10.8	10.8
										10.8-15.6	13.0	11.5-14.8	13.3-15.4	10.5	10.5
										(13.1)	(13.0)	(13.8)	(14.2)		
										9.9-12.5	11.2-12.5	12.1-13.0	12.8-13.8		
										(11.2)	(11.9)	(12.1)	(13.1)		

: Stock market yield was calculated considering both capital gains and dividend together for individual scrips (adjusted for rights and bonus share) level and then taking weighted average of them according to the share to aggregate market capitalisation of SENSEX scrips, as given in 'Returns on Indian Equity Shares' by L.C.Gupta (sponsored by BSE), July 2000.

* : Relates to five major public sector banks as at end-March.

** : Worked out as total payment to policy holders as percentage of Life Fund.

: Interest rates on small savings schemes were changed w.e.f April 1991, April 1992, September 2, 1993, January 1, 1999 and January 15, 2000.

: Relating to NBFCs excluding RNBCs for whom there is no interest rate ceiling but a floor.

\$: Represents interest rates offered on corporate debentures traded at WDM segment of NSE; figures in brackets represent weighted averages using amount raised as weights for some years. In respect of some maturity periods, there was only one issue.

- : Not Available

@ : US-64, data for which relate to July-June, is the oldest and the single largest mutual fund scheme in the country. However, it does not reflect the entire industry.

\$\$: Data relate to term-deposits raised by three major DFIs, such as, IDBI, ICICI and IFCI.

Source : 1. Report on Currency and Finance, Vol II, various issues.

2. Handbook of Statistics on Indian Economy, 1998-99.

3. NSE for Corporate Debentures.

4. In respect of company and DFIs deposits, data were generated internally.

deposits, the degree or extent of movement was not the same. As a result, the gap or differential between interest rates on term deposits of banks and most of the other instruments narrowed down between end-March 1991 and end-March 1999 (Table 3).

Table 3 : Interest rate Differential between Term Deposits of Scheduled Commercial Banks and Other Fixed Income Instruments*
(In per cent)

Year	Post Office Time Deposits	Post Office Recurring Deposits	Post office Monthly Income Scheme	PPF	NSC VIII	KVP	Deposits with NBNFCs	Deposits with NBFCs	Corporate Debentures	Term Deposits with DFIs
1991-1992	1.5 to 2.5	1.5	1.0	1.0	1.0	-0.43	- 0.75 to 2.5	- 4.0@	- 6.5 to 6.7@	-2.8#
1999-2000	Nil	Nil	-0.5	-0.5	-0.5	-0.75	- 4.00 to 4.25	-3.58 to 4.5	-2.6 to 2.9	-2.5

* The gap or differential in the interest rates worked out on the basis of nearest comparable maturities.

@ For 1993-94.

For 1992-93.

Note:- + ve sign indicates interest rate on term deposits of commercial banks is higher, while -vc sign indicates lower.

Source: Table 2.

3.46 It may be observed from Table 3 that during 1991-92, bank deposits carried a higher rate of interest in comparison with all small savings instruments barring KVP. However, by 1999-2000, the interest rates on bank deposits were either on par or somewhat lower (50 to 75 basis points) than all the small saving instruments. Thus, between 1991-92 and 1999-2000, in terms of pure rate of return (i.e., without adjusting for tax benefits), attractiveness of banks' term deposits declined *vis-a-vis* all small saving instruments (post office time deposits, recurring deposits, monthly income scheme, PPF and NSCs and KVP). The attractiveness of bank deposits also reduced *vis-a-vis* deposits with NBNFCs. However, there was not much change in the attractiveness of bank deposits *vis-a-vis* NBFCs deposits between 1993-94 and 1999-2000. Although the gap between the interest rates on corporate debentures and term deposits of banks narrowed down over the period, the corporate debentures still continue to carry a better rate of return than bank deposits.

3.47 It may also be noted that, except NBFC deposits, the gap between the interest rates on bank deposits and other instruments narrowed down between 1990-91 and 1999-2000. This suggests that some convergence of various interest rates has been taking place, although the attractiveness of bank deposits has declined in the process. Major features of various savings instruments are summed up in Table 4.

3.48 Safety, return, liquidity, convenience, and tax benefits are the five major features of saving instruments. However, no single instrument would combine all the features, especially because return and risk are normally inversely related. A comparison of various features of saving instruments suggests that, though bank deposits offer somewhat lower rate of return as compared with many other instruments, they are very safe and liquid and provide considerable convenience to the depositors because of the wide network of branches the banks have. It is hard to point out any other instrument which combines the features of safety, liquidity and convenience in the same proportion as bank deposits. While small savings, LIC policies and deposits/bonds of DFIs are also safe, they lack in terms of liquidity and convenience. The rate of return on LIC policies is not very attractive, but the policies are purchased with some different objective. Units of mutual funds and company shares now enjoy better tax benefits in comparison with other saving instruments. However, both these instruments carry market risks. Also, despite some movement in the recent past, company shares, in general, lack liquidity. Units even of open ended schemes of mutual funds are not as liquid as bank deposits. Company deposits offer the highest rate of interest amongst all fixed income instruments. However, they carry an element of higher risk. Besides, they also lack in terms of liquidity and convenience.

3.49 In this context, it may be useful to note that the recent survey of Indian investors carried out by National Council of Applied Economic Research (NCAER) under the aegis of Securities and Exchange Board of India (SEBI)⁶ also established that the investors prefer to rely on traditional institutions, such as, banks and post offices. The survey found safety and liquidity as the primary consideration which determined the choice of an asset. From the point of view of safety, banks deposits

⁶ SEBI-NCAER (2000): *Survey of Indian Investors*, June.

Table 4: Main Features of Various Saving Instruments- As on 31st March, 2000 (contd.)

Instrument	Annual Yield (Per cent)	Maturity (Years)	Major Terms and Conditions	Tax Benefits	Safety
1. Bank Deposits	5 - 7.5 8 - 9 9.5 - 10 10 - 10.5	Up to 1 year 1-2 2-3 3 years and above	Premature withdrawals allowed.	Interest income up to Rs. 12,000 is free from tax.	Safe
2. Units of Mutual Funds (Income Fund)					
a) Bond Funds	11-13 *	Open- ended	For early withdrawal some funds charge exit load.	Dividend is tax free. Capital gains tax on value appreciation.	Carry market Risk
b) UTI 's Monthly Income Plan Scheme, 2000	9.5-10 ***	5 @@@		Interest received is fully exempted under the Income Tax Act.	-do-
3. Small Savings					
i) Certificates					
a) NSCs VIII	11.5	6	Premature withdrawal is not allowed except in case of death of the investor.	Tax rebate up to Rs. 12,000. Interest income is tax free up to Rs.12,000.	Safe
b) KVP	11.25	6.5	Withdrawal allowed after initial lock-in period of three years with some loss of interest.	No Tax benefits.	Safe
ii) PPF	11	7 @	50 per cent of the deposit as at end of the fifth year are allowed to be withdrawn in seventh year after commencement of the deposit.	Tax rebate up to Rs. 12,000. Entire income is tax free without any limit.	Safe
iii) Post Office Deposits					
a) Saving Bank Account ##	4.5	No fixed term	Liquid	Interest income is tax free up to Rs.12,000.	Safe
b) Recurring Deposits ###	11.5	5	Premature withdrawal allowed with loss of interest.	Interest income is tax free up to Rs.12,000 Under section 80L.	Safe
c) Time Deposits ###	9.0 10.0 11.0 11.5	1 2 3 4	-do-	-do-	Safe
d) Post Office Deposits Monthly Income Scheme \$	11**	6	5 per cent discount on premature withdrawal up to 3 years. #	-do-	Safe
iv) National Saving Scheme, 92	11.0	3	Can be withdrawn after initial lock-in period of three years.	-do-	Safe
4. LIC Policies	7.15@@@	Different LIC policies have different maturity periods.	1.Policies can be surrendered before maturity. 2.Loan against policies also possible.	1. Tax benefit us 80 ccc of the IT Act. 2. Tax rebate up to Rs. 12,000 under sec.88 of the IT Act. 3. Maturity proceeds from all types of schemes are tax free u/s 10.	Safe

Table 4: Main Features of Various Saving Instruments- As on 31st March, 2000 (concl.d.)

Instrument	Annual Yield (Per cent)	Maturity (Years)	Major Terms and Conditions	Tax Benefits	Safety
5. Equity Shares	-	No fixed maturity	Listed on Stock Exchanges.	Dividend income is free.	Carry market Risk
6. Company Deposits					
i)NBNECs	9-16 10-16 13-15	1 2 3	Premature withdrawal not allowed for less than 3 months. Premature withdrawal for other periods allowed with some penal interest.		Risky
ii)NBFCs	10-16 11-18 11.6-18	1 1-3 Above 3	-do-		Risky
7. Company Debentures	9.9-12.5 11.2-12.5 12.1-13.0 12.8-13.8	Less than 1 yr. 1-2 2-5 Above 5 yrs.	Normally listed on stock exchanges but on some there is no much trading.	..	Secured but carry some risk
8. Bonds of DFIs	10.5 10.5	1-3 3-5	Put and call options available on some bonds.	Infrastructure bonds enjoy tax benefit under section 88 of IT Act.	Safe

* Rates indicated are average.

** The deposit carries a 10 per cent bonus at the time of maturity after six years.

*** Assured rate of interest for one year only.

@ 15-year scheme with withdrawals allowed annually beginning the 7th year.

@@ Minimum lock-in period 3 years.

@@@Worked out as total payment to policy holders as percentage of Life Fund.

\$ Minimum deposit of Rs. 6,000 and a maximum of Rs. 2.04 lakh in a single account, or Rs. 4.08 lakh in a Joint account.

Deposit could be cancelled after one year (or up to 3 years) but there is a 5 per cent penalty on the principal and interest earned.

There is a ceiling of Rs. 50,000 for single account and Rs. 1 lakh for joint account.

No ceiling.

- Not available.

Nil

Note : Figures within brackets indicate the actual yield (over 7 years period) adjusted for tax rebatc.

were considered very safe. Debentures were perceived to be nearly as risky as equity. Attractiveness of NBFCs have been found to be on the decline. Fixed deposits as a class had the highest preference, followed by recurring deposits of post office, LIC policies, small saving instruments, contractual savings, UTI schemes, bonds of public sector undertakings, chit funds and public and private sector mutual funds. Bank fixed deposits has an appeal across all income classes. Tax has an influence particularly among the middle and higher income groups but has little relevance to lower income group. There was a fairly high incidence of households in LIC policies across all income groups. According to the survey, despite their growth, the mutual funds have not yet become an attractive investment avenue for the low and middle income groups. A very large percentage of households have not participated so far in the securities market.

CHAPTER 4

TRENDS IN SAVINGS MOBILISATION UNDER VARIOUS INSTRUMENTS

4.1 Data on various saving instruments are available from two different sources, i.e., household sector savings in the financial assets (which are used for estimating gross domestic savings) and individual series available from various sources, such as, bank deposits from returns under Section 42 of the RBI Act, small savings from National Savings Organisation, company deposits from surveys conducted by RBI from time to time, savings with LIC as reflected in LIC pre mia collected from policy holders and as available in the Annual Report of LIC, units of mutual funds as brought by RBI/SEBI, etc. Data on household sector savings in the financial assets do not give a complete picture because such savings constitute about 45 per cent of gross domestic savings. However, the main advantage of such data is that they are available for various saving instruments on a uniform basis and could be used for analysing the changes in their relative significance over the period. This is not possible with individual data series from other sources as they are not available on a uniform basis. While data on some instruments are available on a 'stock' basis, such as bank deposits, data on some other instruments are available on a 'flow' basis, such as units of mutual funds. As a result, it becomes difficult to aggregate the data and assess the relative significance of various savings instruments. However, analysis of individual data series is necessary to have a complete picture of trends in the various saving instruments. Therefore, in this study, both sets of data have been used for analysing the trends in the saving instruments during the 1990s.

i) Trends in Savings - Household sector

4.2 Data on various financial assets of the household sector, viz., bank deposits, non-banking deposits, pension/provident funds, claims on Government, shares and debentures and units of mutual funds, from the year 1990-91 to 1998-99, annual growth rates, the share of each instrument with respect to GDS are set out in Table 5.

4.3 Between 1990-91 to 1998-99, most of the saving instruments, viz., bank deposits, non-banking deposits (with NBFCs and NBNFCs), claims on Government, shares and debentures and units of mutual funds showed wide variations in their growth rates. Contractual savings in the form of Life Insurance Fund and Provident and Pension Funds showed relatively less variations. Over the period, however, the share of all the instruments, except shares and debentures and units of mutual funds, in the GDS tended to move up.

4.4 During the period from 1990-91 to 1998-99, the annual growth rate of bank deposits varied between -3.7 per cent and 65.3 per cent, non-banking deposits between -70.1 per cent and 172.1 per cent, life insurance fund between 1.6 per cent and 34.2 per cent, pension and provident funds between 4.8 per cent and 51.9 per cent, claims on government between -38.5 per cent and 90.9 per cent, shares and debentures between -47.7 per cent and 54.8 per cent and units of mutual funds between -72.6 per cent and 612.9 per cent. However, for the entire period, units of mutual funds grew at the highest average annual rate of 80.4 per cent followed by non-banking deposits (49.5 per cent), claims on Government (25.8 per cent), bank deposits (24.8 per cent), Life Insurance Fund (19.8 per cent), Provident and Pension Funds (20.8 per cent). Shares and debentures, which grew rapidly during 1991-92 to 1994-95, showed negative average annual growth of 31.7 per cent between 1995-96 and 1998-99 and for the period on the whole, the average annual rate was 5.7 per cent. Units of mutual funds, which showed high rates of growth of 147.4 per cent and 108 per cent during 1990-91 and 1991-92, respectively, showed generally negative growth rates thereafter, barring 1996-97 and 1998-99. While, on the whole, units of mutual funds grew at an annual average rate of 80.4 during the period from 1990-91 to 1999-2000, it was due mainly to extraordinary high growth of 612.9 per cent during 1996-97 over the low base of the previous year. Excluding the year 1996-97, the average annual growth rate worked out to 13.9 per cent (Table 5).

4.5 As a result of divergent pattern of growth, significant changes were observed in the relative position of various instruments in relation to GDS. The share of bank deposits, which constituted 14.5 per cent of GDS during 1990-91, increased to 22.2 per cent by 1994-95. After declining to 13.3 per cent during 1995-96, the share rose

Table 5: Trends in Financial Savings of the Household Sector - Component-wise

Year (April-March)	Bank Deposits		Non-banking Deposits		Life Insurance Fund		Provident and Pension Funds		Claims on Government		Shares & Debentures		Units of Mutual Funds		Total Financial Savings		Gross Domestic Savings	
	Amount	Per cent to GDS	Amount	Per cent to GDS	Amount	Per cent to GDS	Amount	Per cent to GDS	Amount	Per cent to GDS	Amount	Per cent to GDS	Amount	Per cent to GDS	Amount	Per cent to GDS	Amount	Per cent to GDP
1990-91	18777 (34.2)	14.5	1286 (-30.1)	1.0	5599 (26.8)	4.3	11155 (17.3)	8.6	7883 (16.6)	6.1	3019 (13.7)	2.3	5391 (147.4)	4.1	53110 (28.5)	40.9	129940 (26.9)	24.3
1991-92	17880 (-4.8)	12.7	2218 (72.5)	1.6	7003 (25.1)	5.0	12501 (12.1)	8.9	4845 (-38.5)	3.4	4673 (54.8)	3.3	11214 (108.0)	7.9	60334 (13.6)	42.7	141192 (8.7)	22.9
1992-93	29550 (65.3)	19.0	6035 (172.1)	3.9	7114 (1.6)	4.6	14814 (18.5)	9.5	3885 (-19.8)	2.5	6931 (48.3)	4.5	6893 (-38.5)	4.4	75222 (24.7)	48.5	155160 (9.9)	22.0
1993-94	36200 (22.5)	18.9	11654 (93.1)	6.1	9548 (34.2)	5.0	18226 (23.0)	9.5	6908 (77.8)	3.6	8795 (26.9)	4.6	5977 (-13.3)	3.1	97308 (29.4)	50.8	191476 (23.4)	22.3
1994-95	55834 (54.2)	22.2	11547 (-0.9)	4.6	11370 (19.1)	4.5	21295 (16.8)	8.5	13186 (90.9)	5.2	11827 (34.5)	4.7	5555 (-7.1)	2.2	130614 (34.2)	52.0	251400 (31.3)	24.9
1995-96	39941 (-28.5)	13.3	13198 (14.3)	4.4	13894 (22.2)	4.6	22311 (4.8)	7.5	9588 (-27.3)	3.2	8495 (-28.2)	2.8	606 (-89.1)	0.2	108033 (-17.3)	36.1	299288 (19.0)	25.3
1996-97	50902 (27.4)	14.8	25980 (96.8)	7.6	16121 (16.0)	4.7	25617 (14.8)	7.4	11784 (22.9)	3.4	6101 (-28.2)	1.8	4320 (612.9)	1.3	140825 (30.4)	41.0	343893 (14.9)	25.3
1997-98	79514 (56.2)	22.5	7775 (-70.1)	2.2	19431 (20.5)	5.5	32808 (28.1)	9.3	22164 (88.1)	6.3	3190 (-47.7)	0.9	1182 (-72.6)	0.3	166064 (17.9)	47.0	353232 (2.7)	23.3
1998-99	76590 (-3.7)	19.5	15376 (97.8)	3.9	21867 (12.5)	5.6	49841 (51.9)	12.7	27004 (21.8)	6.9	2468 (-22.6)	0.6	2081 (76.1)	0.5	195227 (17.6)	49.6	393601 (11.4)	22.3
Average Annual Growth Rates (Per cent per annum) 1990-91 to 1998-99	24.8		49.5		19.8		20.8		25.8		5.7		80.4		19.9		16.5	
1990-91 to 1994-95	34.3		61.3		21.4		17.6		25.4		35.6		39.3		26.1		20.0	
1995-96 to 1998-99	12.9		34.7		17.8		24.9		26.4		-31.7		131.8		12.1		12.0	

GDS : Gross Domestic Savings.

Note : Figures within brackets represent percentage variations over the previous year.

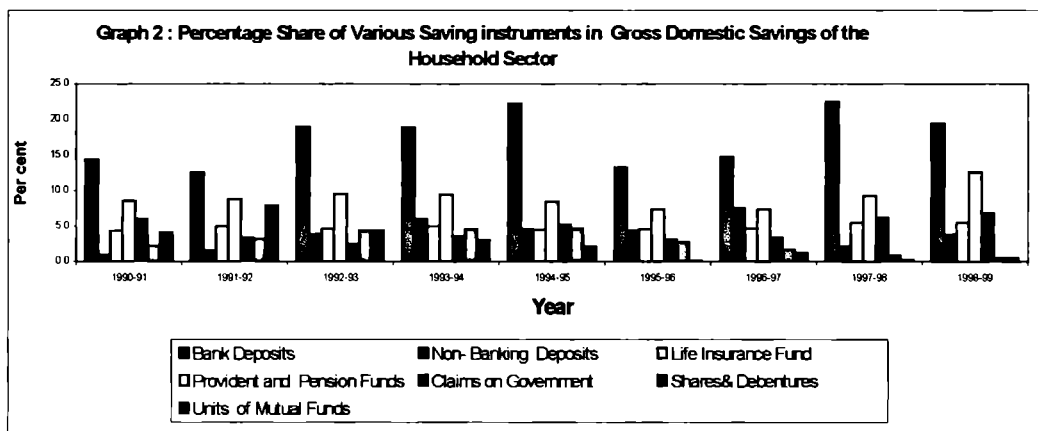
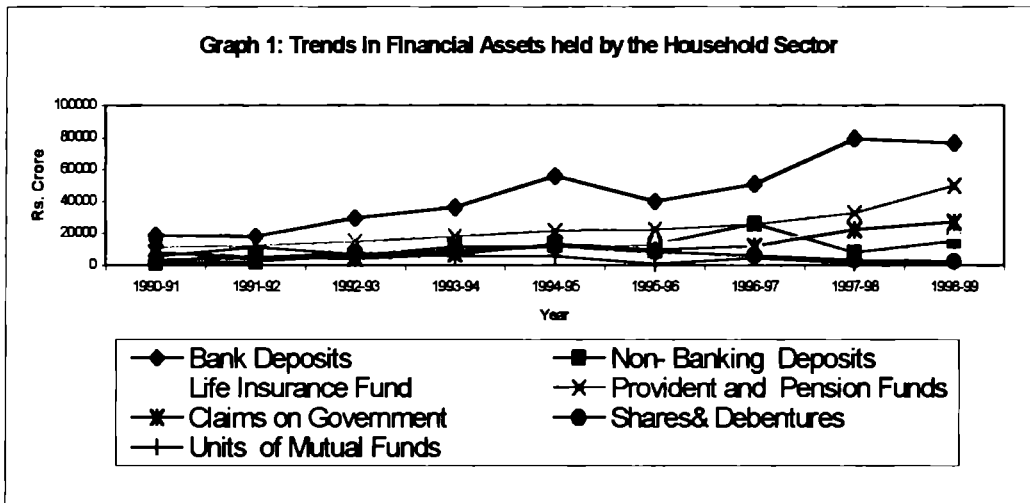
Source: RBI, Handbook of Statistics on Indian Economy, 1999.

to 19.5 per cent by 1998-99. The share of non-banking deposits, which was 1.0 per cent of GDS during 1990-91, increased almost gradually to 7.6 per cent by 1996-97. It declined sharply to 2.2 per cent during 1997-98 before recovering to 3.9 per cent during 1998-99. The life insurance fund maintained more or less a steady trend with its share increasing from 4.3 to 5.6 per cent. The share of provident and pension funds, which moved in the range of 7.4 per cent and 9.5 per cent between 1990-91 and 1997-98, increased sharply to 12.7 per cent during 1998-99. The share of claims on Government, which was 6.1 per cent during 1990-91, declined sharply to 3.4 per cent during 1991-92 and moved narrowly till 1996-97. It, however, increased sharply to 6.9 per cent by 1998-99. Savings in shares and debentures, which constituted 2.3 per cent of GDS during 1990-91, rose to 4.7 per cent of GDS during 1994-95 before declining to 0.6 per cent during 1998-99. In case of units of mutual funds, the share increased sharply from 4.1 per cent during 1990-91 to 7.9 per cent by 1991-92 but declined almost gradually to 0.5 per cent by 1998-99 (Table 5 and Graphs 1 and 2).

4.6 While the above analysis provided some insight into the absolute as well as the relative growth of various saving instruments, an important question that needs to be addressed is whether liberalisation process has had any adverse impact on the banks role in savings mobilisation.

4.7 During the period from 1990-91 to 1998-99, bank deposits grew at an average annual rate of 24.8 per cent. This growth rate was much higher than the total financial savings and gross domestic savings which grew at an average annual rate of 19.9 per cent and 16.5 per cent, respectively. The growth rate of bank deposits decelerated sharply in the second half of 1990s. The average annual growth rate which was 34.3 per cent during 1990-95, decelerated sharply to 12.9 per cent during 1995-99. However, deceleration of bank deposits in the second half should be seen in the context of deceleration of overall financial savings which decelerated to 12.1 per cent from 26.1 per cent during these periods. Thus, despite the deceleration, bank deposits during the period 1995-99 grew at a somewhat higher rate (12.9 per cent) as compared with the growth rate of overall financial savings (12.1 per cent). In fact, bank deposits as percentage of GDS showed sharp improvement to 19.5 per cent during 1998-99 from 14.5 per cent during 1990-91 (Table 5).

4.8 It may also be noted that during the 1990s, bank deposits grew faster than all other financial assets combined together. While bank deposits grew at an average annual rate of 24.8, all other financial assets combined together grew at an average annual rate of 12.6 per cent. As a result, the share of bank deposits in total financial assets increased from 31.9 per cent in 1990-91 to 44.5 per cent by 1997-98 before declining to 35.3 per cent by 1998-99, while that of all other financial assets declined from 58.3 per cent to 54.6 per cent between 1990-91 and 1998-99 (Table 6).



4.9 The above analysis suggests that the growth of bank deposits was not affected adversely during the 1990s. Bank deposits grew at an average annual rate of about 25 per cent which was much higher than the rates at which both the financial savings and gross domestic savings grew. Bank deposits also grew faster than all other financial assets combined together.

4.10 While bank deposits maintained their overall growth during the 1990s, data do suggest that in some years bank deposits were substituted in favour of some other instruments.

4.11 Bank deposits as saving instruments in the gross financial saving of the household sector grew at a reasonably high rate during each of the nine years from 1990-91 to 1998-99, barring three years, i.e., 1991-92, 1995-96 and 1998-99 when they registered negative growth rates. Bank deposits declined by 4.8 per cent during 1991-92 (as compared with the increase of 34.2 per cent in the previous year), 28.5 per cent during 1995-96 (as compared with the increase of 54.2 per cent in the previous year) and 3.7 per cent during 1998-99 (as compared with the increase of 56.2 per cent in the previous year). During these three years, bank deposits' share in gross domestic savings also declined sharply in comparison with previous years.

4.12 Bank deposits declined by 4.8 per cent during 1991-92. During the same year, on the other hand, shares and debentures, units of mutual funds and non-banking deposits increased sharply by 108.0 per cent, 54.8 per cent and 72.5 per cent, respectively, compared with the increases of 147.4 per cent, 13.7 per cent and a decline of -30.1 per cent, respectively, in the previous year. Like-wise, their shares in GDS increased sharply to 7.9 per cent, 3.3 per cent and 1.6 per cent, respectively, during 1991-92 as compared with 4.1 per cent, 2.3 per cent, and 1.0 per cent, respectively, in the previous year. The only other item which declined during 1991-92 was claims on government (by 38.5 per cent as compared with an increase of 16.6 per cent) due mainly to the decline in the post office time deposits. The share of claims on Government in GDS also declined sharply to 3.4 per cent from 6.1 per cent. Although the growth rate of life insurance fund and provident and pension funds decelerated during 1991-92, their shares in GDS increased marginally. This suggests that the gain in the absolute and relative importance of capital market instruments and

non-banking deposits during 1991-92 was largely at the expense of bank deposits and to some extent at the cost of post office time deposits.

4.13 During 1995-96, bank deposits declined sharply by 28.5 per cent (as compared with the increase of 54.2 per cent in the previous year) and its share as per cent of GDS declined to 13.3 per cent from 22.2 per cent in the previous year. However, 1995-96 witnessed a decline in the share of almost all other instruments resulting in decline in the overall financial savings by 17.3 per cent. The share of total financial savings in gross domestic savings also declined to 36.1 per cent from 52.0 per cent. This would suggest that the decline in bank deposits during 1995-96 was the result of deceleration of overall financial savings and due to shifting of funds to other instruments.

4.14 During 1998-99, bank deposits declined by 3.7 per cent (as compared with an increase of 56.2 per cent in the previous year) and its share in the GDS to 19.5 per cent (from 22.5 per cent in the previous year). However, during the same year, non-banking deposits grew sharply by 97.8 per cent (as compared with negative growth of 70.1 per cent in the previous year) and their share in GDS increased to 3.9 per cent (from 2.2 per cent in the previous year). Units of mutual funds also increased sharply by 76.1 per cent as compared with a negative growth rate of 72.6 per cent in the previous year. The shares of all other instruments showed either marginal increases or decline except pension and provident funds, which increased sharply by 51.9 per cent and their share in GDS increased to 12.7 per cent from 9.3 per cent in the previous year. However, sharp rise in pension and provident funds was due perhaps to transfer of employees dues as recommended by the 5th Pay Commission and not due to shifting of funds from other instruments. Thus, the decline in bank deposits during 1998-99 was caused by substitution⁷ of funds in favour of deposits with non-banking companies and units of mutual funds.

4.15 During 1993-94, when bank deposits decelerated sharply to 22.5 per cent from 65.3 per cent in the previous year, non-banking deposits grew sharply by 93.1

⁷ Substitution does not necessarily mean that investible funds are diverted from banks to other saving instruments (although this possibility cannot be ruled out) but that the funds, instead of being deployed in bank deposits, are deployed in some other instruments.

per cent (on top of the increase of 172.1 per cent in the previous year) and their share in GDS also increased to 3.9 per cent from 1.6 per cent in the previous year. During the same year, shares and debentures also moved up sharply by 26.9 per cent and their relative share in GDS increased marginally to 4.6 per cent from 4.5 per cent. All other instruments either showed decelerated or negative growth or increased only marginally (Table 5).

4.16 The above analysis suggests that at different points of time, different instruments competed with bank deposits as the preferable means of saving. The negative growth of bank deposits and their resultant decline in the share of GDS during 1991-92 was due mainly to a sharp rate of growth in the capital market related instruments, i.e., shares and debentures and units of mutual funds and, to some extent, non-banking deposits. The deceleration in bank deposits during 1993-94 was due mainly to sharp increase in shares and debentures. During 1998-99, the deceleration of bank deposits was due mainly to non-banking deposits and, to some extent, units of mutual funds. Thus, whenever there was a decline or deceleration in bank deposits, there was an increase in units of mutual funds or shares/ debentures/bonds or company deposits or a combination thereof. Life Insurance funds, provident and pension funds, the investment in which are meant to serve different purposes, showed a tendency to grow at a steady rate and did not seem to be competing with bank deposits.

4.17 Although savings instruments are of different types, they could be categorised based on some common characteristics. For instance, units of mutual funds are different from shares/debentures, but both are capital market instruments and carry market risk. Like-wise, savings in LIC policies and provident/ pension funds are for different purposes but both are contractual in nature. The analysis of data based on this type of categorisation would enable us to find out the changes in the relative importance of these sectors. Two categories into which savings data could be divided are (a) Contractual savings *vis-a-vis* non-contractual savings, and (b) Capital market or risk-based instruments *vis-a-vis* other instruments.

4.18 Data on the above categories have been set out in Table 6 and the broad trends emerging from the analysis are as under:

Table 6: Trends in Financial Savings of the Household Sector -- Category - wise

Year (April-March)	Bank Deposits vis-à-vis Non-Bank Savings*				Capital Market vis-à-vis Non-Capital Market based Savings*				Contractual vis-à-vis Non-Contractual Savings*			
	Bank Deposits		Non-bank Savings		Capital Market based Savings		Non-Capital Market based Savings		Contractual Savings		Non - Contractual Savings	
	Growth rate (%)	% Share in total Financial Assets	Growth rate (%)	% Share in total Financial Assets	Growth rate (%)	% Share in total Financial Assets	Growth rate (%)	% Share in total Financial Assets	Growth rate (%)	% Share in total Financial Assets	Growth rate (%)	% Share in total Financial Assets
1990-91	34.2	31.9	-30.1	58.3	74.0	14.3	22.4	75.9	20.3	28.4	32.6	61.7
1991-92	-4.8	26.3	23.7	62.4	88.9	23.3	-0.6	65.3	16.4	28.6	12.3	60.0
1992-93	65.3	36.8	7.6	56.8	-13.0	17.2	38.1	76.4	12.4	27.3	30.5	66.3
1993-94	22.5	33.1	33.8	55.8	6.9	13.5	34.4	75.4	26.7	25.4	30.5	63.5
1994-95	54.2	38.4	22.4	51.4	17.7	12.0	37.2	77.9	17.6	22.5	40.9	67.4
1995-96	-28.5	32.4	-8.9	55.2	-47.6	7.4	-12.6	80.2	10.8	29.3	-26.7	58.2
1996-97	27.4	33.0	32.1	58.3	14.5	6.8	31.8	84.6	15.3	27.1	38.0	64.3
1997-98	56.2	44.5	-3.8	48.5	-58.0	2.4	24.0	90.5	25.2	29.3	14.9	63.7
1998-99	-3.7	35.3	37.1	54.6	4.0	2.1	17.9	87.8	37.3	33.0	8.5	56.9
Average Annual Growth Rates (Per cent per annum)												
1990-91 to 1998-99	24.8		12.6		9.7		21.4		20.2		20.2	
1990-91 to 1994-95	34.3		11.5		34.9		26.3		18.7		29.4	
1995-96 to 1998-99	12.9		14.1		-21.8		15.3		22.1		8.7	

* Percentage share of two given categories in total financial assets may not add up to 100 as 'currency' and 'trade debt' which form part of financial assets have not been included.
Source: Worked out from data from Handbook of Statistics on Indian Economy, 1999, RBI.

(i) The growth rate of contractual savings (LIC policies and pension/provident funds) which worked out generally less than 20 per cent (except 1992-93 when it was 26.7 per cent) between 1991-92 and 1996-97, increased to 25.2 per cent during 1997-98 and 37.3 per cent during 1998-99. On an average, contractual savings grew at an average annual rate of 20.2 per cent during the period between 1991-92 to 1998-99, while non-contractual savings at 18.6 per cent. As per cent of financial assets, the share of contractual savings increased from 28.4 per cent during 1990-91 to 33.0 per cent during 1998-99, while that of non-contractual savings declined correspondingly from 61.7 per cent to 56.9 per cent.

(ii) Two main risks associated with savings are market risk and default risk. All capital market based instruments, such as, shares, debentures and units of mutual funds, carry market risk. Grouping of data into capital market-based (or market risk based instruments) and non-capital market-based instruments (or non-risky instruments) revealed that, after growing fast in the first two years of the 1990s, capital market-based instruments suffered a sharp set back in the subsequent years. On the whole, during the period from 1991-92 to 1998-99, capital market based instruments grew at an average annual rate of 9.7 per cent as against a growth rate of 21.4 per cent in the case of non-capital market based instruments. Year to year growth of capital market-based instruments was marked by wide variations. Their share in the total financial assets, after increasing sharply from 14.3 per cent in 1990-91 to 23.3 per cent during 1991-92, declined gradually to 2.1 per cent by 1998-99. The share of non-capital market-based instruments increased from 75.9 per cent to 87.8 per cent between 1990-91 and 1998-99.

4.19 The main findings emerging from the financial savings of the household sector analysis for the period 1990-91 to 1998-99 are summed up below:

(a) All saving instruments showed wide year to year variations during the period from 1990-91 to 1998-99. However, life insurance fund and pension and

- provident funds showed relatively less variations as compared with other instruments.
- (b) During the 1990s, units of mutual funds grew at the fastest rate, followed by non-banking deposits, claims on Government, bank deposits, LIC policies, pension and provident funds and shares and debentures. The fast growth of units of mutual funds was due mainly to extraordinary high growth of 612.9 per cent during 1996-97 over very low base of the previous year. Excluding 1996-97, units of mutual funds grew at an average annual rate of 13.9 per cent, which was the second lowest after shares and debentures.
 - (c) Shares and debentures, which grew rapidly between 1991-92 and 1994-95, registered negative growth rates in the following years. Units of mutual funds, which grew rapidly during 1991-92, registered a generally negative growth thereafter. As a result, the relative importance of all capital market related instruments (shares and debentures and unit of mutual funds) declined significantly between 1991-92 and 1998-99, while that of non-capital market instruments increased.
 - (d) Contractual savings in the form of life insurance policies and pension and provident funds maintained generally a steady trend, although there was some improvement in their relative importance between 1990-91 and 1998-99.
 - (e) Notwithstanding some variations, banks maintained their dominant position in the mobilisation of savings and there was no adverse impact on the growth of bank deposits during the 1990s. Bank deposits grew at an average annual rate of about 25 per cent, which was much higher than the rate at which total financial savings grew (20 per cent). The share of bank deposits in gross domestic savings increased sharply between 1990-91 and 1998-99, suggesting sharp improvement in the relative significance of bank deposits during the 1990s. Bank deposits decelerated sharply in the second half of 1990s, which needs to be seen in the context of sharp deceleration in the overall financial savings. **While bank deposits maintained their overall growth during the 1990s, there was an evidence to suggest that, in some years, there were substitution in favour of either units of mutual funds or shares/debentures or company deposits or a combination thereof.**

(ii) Trends in Saving Instruments - Individual Data Series

4.20 An analysis of trends in the financial assets of the household sector clearly brought out the changes in the significance of various saving instruments during the 1990s. Although the analysis threw some useful light on the changing significance of various saving instruments, it being related to household sector only suffered from a limitation in that it covered only around 50 per cent of the GDS and 74 per cent of total financial savings. The sectors not covered are private corporate and Government. It was also not possible to go into detail in the absence of disaggregated information in respect of almost all the instruments. Also, data on household sector savings were available up to 1998-1999, while it was during the year 1999-2000 that some major tax concessions were announced for units of mutual funds. Owing to these reasons, it becomes necessary to supplement the analysis based on household sector savings with other data. In this section, therefore, we analyse the trends in the various savings instruments based on individual data series.

4.21 In order to assess the banks' role in savings mobilisation during the 1990s, the analysis was attempted in two directions: (a) analysis of bank deposits during the 1990s *vis-a-vis* during 1980s, and (b) analysis of bank deposits during the 1990s *vis-a-vis* various other instruments during the same period.

4.22 During the 1990s, bank deposits grew at an average annual rate of 17.1 per cent as compared with 18.1 per cent during the 1980s and 20.6 per cent during the 1970s (Table 7).. Other savings instruments whose growth rate decelerated during the 1990s as compared with the 1980s were: deposits with NBNFCs (to 12.7 per cent from 17.2 per cent), certificates (to 16.1 per cent from 37.5 per cent), PPF (to 19.5 per cent from 33.1 per cent), units of mutual funds (to -3.9 per cent from 71.1 per cent), and corporate debentures (to -5.7 per cent from 83.2 per cent). Some instruments, however, showed accelerated growth, such as, deposits with NBFCs (to 78.1 per cent from 26.7 per cent), post office deposits (to 14.2 per cent from 10.1 per cent), LIC policies (to 19.8 per cent from 18.0 per cent) and shares (to 53.6 per cent from 42.6 per cent). On an aggregate basis, the following categories of instruments showed decelerated growth during the 1990s as compared with the 1980s; small savings (to 15.1 per cent from 20.4 per cent) and capital market based instruments (to 18.8 per

Table 7: Trends in Various Saving Instruments - Individual Data Series

Period	Bank Deposits	Company Deposits@			Small Savings				LIC Policies	Capital Market Instruments					Total Capital Market (Col.11,12 & 15)
		NBFCs	NBNFCs	Total	Certificates	Deposits	PPF	Total		Units of Mutual Funds (Net)	Bonds of DFIs #	Shares & Debentures			
												Shares	Corporate Debentures	Total	
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Average Annual Growth Rate (Per cent per annum)															
1970-71 to 1979-80	20.6	20.4	21.3	20.8	34.8	19.1	44.0	20.9	13.0	24.5	N.C.	16.7	128.9	22.9	20.6
1980-81 to 1989-90	18.1	26.7	17.2	18.9	37.5	10.1	33.1	20.4	18.0	71.1	N.C.	42.6	83.2	58.4	60.3
1990-91 to 1999-2000	17.1	78.1	12.7	45.3	16.1*	14.2*	19.5*	15.1*	19.8*	-3.9	143.5	53.6	-5.7	14.6	18.8
1990-91 to 1994-95	18.3	91.4	11.8	48.0	14.7	14.2	6.1	13.7	20.8	12.6	N.C.	109.7	23.8	52.8	28.3
1995-96 to 1999-2000	16.0	44.7	15.0	38.5	17.9*	14.1*	36.4*	16.9*	18.6*	-20.3	143.5	-2.6	-35.3	-23.6	9.1
Trend Growth Rate ** (Per cent per annum)															
1970-71 to 1979-80	20.7	18.3	16.3	16.6	27.5	18.8	67.7	20.1	12.8	20.3	N.C.	9.7	6.5	1.1	13.3
1980-81 to 1989-90	18.1	30.5	16.1	18.8	40.0	8.2	27.9	20.5	17.9	66.5	N.C.	29.7	42.7	38.3	48.0
1990-91 to 1999-2000	17.4	82.2	13.8	51.4	15.9**	12.1*	6.1*	14.3*	19.1*	-23.9	32.3	-1.3	-24.3	-8.9	-3.0
1990-91 to 1994-95	18.6	98.7	11.5	53.5	12.3	11.6	-27.6	10.9	19.5	8.5	N.C.	98.5	34.2	61.0	33.4
1995-96 to 1999-2000	17.3	N.C.	N.C.	N.C.	18.8*	16.4*	49.6*	18.4*	17.3*	\$	38.3	-29.5	-54.7	-32.2	17.8
Coefficient of Variation (Per cent)															
1970-71 to 1979-80	53.5	44.3	43.5	43.0	64.1	46.1	73.5	49.2	33.0	67.7	N.C.	30.8	135.3	40.8	43.3
1980-81 to 1989-90	46.7	77.4	39.0	46.5	79.0	22.4	69.4	51.3	52.6	123.4	N.C.	60.1	117.5	92.4	105.8
1990-91 to 1999-2000	44.6	125.0	73.3	110.4	53.4	46.7	67.4	50.9	43.6	96.0	101.0	80.1	66.9	69.8	48.4

@ Values for company deposits are up to 1996-97 as data for the earlier period were not available.

Values for bonds of DFIs relate to the period from 1995-96 to 1999-2000, as data for the earlier period were not available.

\$ Due to negative mobilisation in 1995-96, the trend growth from 1995-96 to 1999-2000 worked out very high and hence value is not reported.

* Up to 1998-99

** Trend growth rates are calculated based on semi-log trend, i.e., for the equation $\ln(Y) = a + bt$, antilog of $(1-b)$ is converted in percentage terms, multiplying it by 100.

N.C. : Not computed.

Note :- For other footnotes, please refer Table 11.

Source :- Table 11

cent from 60.3 per cent). On the other hand, the growth rate of company deposits accelerated to 45.3 per cent from 18.9 per cent. During the 1990s, non-banking deposits grew at the highest average annual rate of 45.3 per cent, followed by LIC policies (19.8 per cent), capital market instruments (18.8 per cent), bank deposits (17.1 per cent) and small savings (15.1 per cent).

4.23 Analysis based on coefficient of variation revealed that bank deposits showed a more consistent growth during the 1990s in comparison with the 1980s and the 1970s. Bank deposits also showed a more consistent growth in comparison with all other saving instruments (barring LIC policies) during the 1990s (Table 7).

4.24 The above analysis revealed that the growth of bank deposits decelerated only marginally during the 1990s as compared with the 1980s. While the liberalisation process did not have much adverse impact on the overall growth of bank deposits, some significant changes were observed in the relative importance of various forms of bank deposits as detailed below:

- i) The average annual growth rate of demand deposits, which was 12.7 per cent during the 1970s, accelerated to 16.0 per cent during the 1980s and further to 17.4 per cent during the 1990s. On the other hand, the growth rate of time deposits decelerated from 25.2 per cent during the 1970s to 18.6 per cent during the 1980s and further to 17.7 per cent during the 1990s.
- ii) The average annual growth rate of savings deposits decelerated from 21.3 per cent during the 1970s to 17.6 per cent during the 1980s and further to 16.0 per cent during the 1990s.
- iii) The growth rate of term deposits which decelerated sharply during the 1980s to 15.4 per cent from 20.8 per cent during the 1970s, decelerated only marginally to 15.3 per cent during the 1990s (Table 8).

Table 8 – Deposits of Scheduled Commercial Banks – Growth Rates

(Per cent)

Category/Year (April-March)	Average Annual Growth Rates		
	1970-71 To	1980-81 To	1990-91 To
	1979-80	1989-90	1998-99
Aggregate Deposits (i+ii)	20.3	18.1	17.1
i) Demand Deposits	12.7	16.0	17.4
ii) Time Deposits	25.2	18.6	17.7
Savings Deposits	21.3	17.6	16.0
Term Deposits	20.8	15.4	15.3

4.25 Although term deposits maintained the same growth rate during the 1990s as that during the 1980s, significant changes were observed in various categories of the maturities. Some of the important changes which took place in the relative importance of various maturities of term deposits are indicated below :

- a) The share of term deposits in the maturity category of '6 months and above but less than 1 year' increased almost gradually from 6.1 per cent as at end-December 1991 to 12.4 per cent by end-December 1999 and that of maturity of '1 year and above but less than 2 years' increased from 14.3 per cent to 22.5 per cent.
- b) The share of deposits in the maturity category of '2 years and above but less than 3 years' declined sharply from 27.1 per cent as at end-December 1991 to 15.8 per cent as at end-December 1999 and of '5 years and above' category declined from 18.6 per cent to 11.8 per cent.
- c) The share of '3 years and above but less than 5 years' maturity category after witnessing variations either way showed some improvement from 20.6 per cent as at end-December 1991 to 22.7 by end-December 1999.
- d) Not much variations were noticed in the relative shares of term deposits with maturity categories of 'up to 90 days' and '191 days and above but less than 6 months' between end-December 1991 and 1999 (Table 9).

4.26 From the above analysis, it is clear that the combined share of term deposits with maturity 6 months and up to 2 years increased from 20.4 per cent as at end-

Table 9: Maturity Pattern of Term Deposits of Scheduled Commercial Banks

(Amount in Rs. crore)

Year	Upto 90 days		91 days and above but less than 6 months		6 months and above but less than 1 year		1 year and above but less than 2 years		2 years and above but less than 3 years		3 years and above but less than 5 years		5 years and above		Total
	Amount	Per cent to Total	Amount	Per cent to Total	Amount	Per cent to Total	Amount	Per cent to Total	Amount	Per cent to Total	Amount	Per cent to Total	Amount	Per cent to Total	
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1991	9,217 (210.4)	8.1	5,897 (100.2)	5.2	7,003 (126.8)	6.1	16,312 (49.5)	14.3	30,927 (39.7)	27.1	23,492 (98.5)	20.6	21,235 (31.2)	18.6	114,082 (62.8)
1992	13,785 (49.6)	10.4	6,254 (6.1)	4.7	8,744 (24.9)	6.6	21,732 (33.2)	16.4	25,642 (-17.1)	19.4	33,953 (44.5)	25.7	22,040 (3.8)	16.7	132,151 (15.8)
1993	21,545 (56.3)	13.1	8,540 (36.6)	5.2	13,572 (55.2)	8.2	35,322 (62.5)	21.4	23,631 (-7.8)	14.3	36,776 (8.3)	22.3	25,371 (15.1)	15.4	164,757 (24.7)
1994	25,737 (19.5)	13.3	13,772 (61.3)	7.1	15,056 (10.9)	7.8	49,195 (39.3)	25.4	26,975 (14.2)	13.9	38,031 (3.4)	19.6	24,855 (-2.0)	12.8	193,620 (17.5)
1995	31,375 (21.9)	14.1	10,026 (-27.2)	4.5	16,452 (9.3)	7.4	66,350 (34.9)	29.8	34,404 (27.5)	15.5	38,530 (1.3)	17.3	25,384 (2.1)	11.4	222,520 (14.9)
1996	31,266 (-0.3)	12.1	15,627 (55.9)	6.1	26,782 (62.8)	10.4	61,277 (-7.6)	23.8	48,988 (42.4)	19	43,657 (13.3)	16.9	30,138 (18.7)	11.7	257,735 (15.8)
1997	32,073 (2.6)	10.4	17,793 (13.9)	5.8	35,425 (32.3)	11.5	65,195 (6.4)	21.1	58,061 (18.5)	18.8	61,120 (40.0)	19.8	38,788 (28.7)	12.6	308,455 (19.7)
1998	41,635 (29.8)	11.1	21,857 (22.8)	5.8	39,392 (11.2)	10.5	79,237 (21.5)	21.2	64,841 (11.7)	17.3	81,092 (32.7)	21.7	46,231 (19.2)	12.4	374,286 (21.3)
1999	38,968 (-6.4)	8.9	25,610 (17.2)	5.8	54,726 (38.9)	12.4	99,119 (25.1)	22.5	69,640 (7.4)	15.8	100,098 (23.4)	22.7	51,906 (12.3)	11.8	440,155 (17.6)
Average Annual Growth Rates (Per cent per annum) 1991 to 1999															
	42.6		31.9		41.4		29.4		15.2		29.5		14.3		23.3

Source : Banking Statistics, Volumes 1990 to 1998.

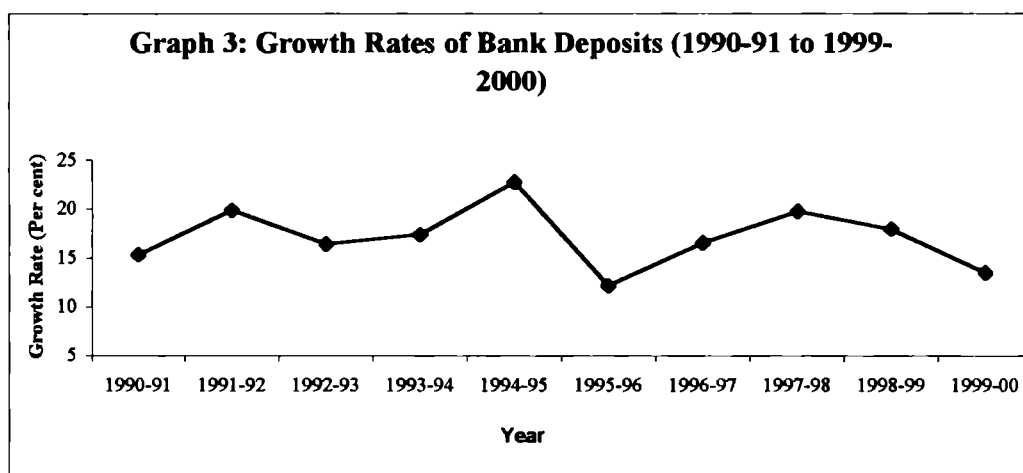
Note : 1. Figures in brackets represent percentage variations over the previous year.

2. Data are on a calendar year basis.

December 1991 to 34.9 per cent as at end-December 1999 and that of 2 years and above maturity declined from 66.3 per cent to 50.3 per cent. This suggests that there was a distinct shift of term deposits in favour of short to medium term maturity.

4.27 It is useful to examine whether data on individual series support the earlier findings based on financial savings of the household sector.

4.28 An analysis of individual data series from 1990-91 to 1999-2000 revealed that the growth rate of bank deposits varied widely from year to year and there were four years when the growth of bank deposits decelerated, viz., 1992-93, 1995-96, 1998-99 and 1999-2000 (Table 10 and Graph 3).



4.29 During 1992-93, the growth rate of bank deposits slowed down to 16.4 per cent from 19.8 per cent in the previous year. On the other hand, investments in shares and debentures increased by 225.3 per cent as compared with 44.0 per cent in the previous year and deposits with companies increased by 22.4 per cent as compared with 11.1 per cent in the previous year (due mainly to sharp growth of deposits with NBFCs which grew by 51.8 as compared with 38.4 per cent in the previous year). The growth rate of all other instruments such as, small savings, units of mutual funds and LIC policies decelerated. Thus, there is a reason to believe that the deceleration of bank deposits during 1992-93 was caused by sharp growth of investment in shares and debentures and deposits with NBFCs.

Table 10: Trends in Various Saving Instruments - Individual Data Series

(Amount in Rs. crore)

Year (April- March)	Bank Deposits @	Company Deposits			Small Savings				LIC Policies	Capital Market Instruments					
		NBFCs	NBNFCs	Total	Certificates	Deposits	PPF	Total		Units of Mutual Funds (Net)	Bonds of DFIs**	Shares & Debentures**			Total - Capital Market
												Shares	Corporate Debentures	Total	
1	2	3	4	5	6	7	8	9	11	10	13	14	15	16	17
1990-91	192541 (15.3)	2041 (15.1)	4706 (11.4)	6747 (12.5)	33387 (21.1)	17535 (20.8)	2595 (15.1)	53517 (20.7)	5601 (24.8)	7508 (10.6)	N.A. (-)	1284 (-)	3015 (-)	4299 (-)	11808 (-)
1991-92	230758 (19.8)	2824 (38.4)	4672 (-0.7)	7497 (11.1)	35744 (7.1)	20255 (15.5)	2596 (-)	58595 (9.5)	6960 (24.3)	11253 (49.9)	N.A. (-)	1916 (49.2)	4275 (41.8)	6192 (44.0)	17444 (47.7)
1992-93	268572 (16.4)	4288 (51.8)	4890 (4.7)	9178 (22.4)	38788 (8.5)	21694 (7.1)	466 (-82.0)	60948 (4.0)	7987 (14.8)	13021 (15.7)	356 (-)	10289 (437.0)	9850 (130.4)	20140 (225.3)	33517 (92.1)
1993-94	315132 (17.3)	17390 (305.6)	5813 (18.9)	23202 (152.8)	43383 (11.8)	23653 (9.0)	660 (41.6)	67696 (11.1)	9735 (21.9)	11243 (-13.7)	N.A. (-)	12946 (25.8)	9370 (-4.9)	22316 (10.8)	33559 (0.1)
1994-95	386859* (22.8)*	25441 (46.3)	7261 (24.9)	32701 (40.9)	54244 (25.0)	28066 (18.7)	1027 (55.6)	83337 (23.1)	11528 (18.4)	11275 (0.3)	N.A. (-)	18570 (43.4)	8871 (-5.3)	27441 (23.0)	38715 (15.4)
1995-96	433819 (12.1)	38711 (52.2)	8040 (10.7)	46751 (43.0)	62452 (15.1)	30248 (7.8)	1028 (0.1)	93728 (12.5)	14182 (23.0)	-5833 (-151.7)	1000 (-)	14420 (-22.3)	3970 (-55.2)	18390 (-33.0)	13557 (-65.0)
1996-97	505599 (16.5)	53116 (37.2)	9592 (19.3)	62708 (34.1)	72839 (16.6)	31800 (5.1)	1472 (43.2)	106111 (13.2)	16240 (14.5)	-2037 (134.9)	4200 (390.0)	7853 (-45.5)	1933 (-51.3)	9787 (-46.8)	12650 (-6.7)
1997-98	605410 (19.7)	N.A. (-)	N.A. (-)	N.A. (-)	86065 (18.2)	38273 (20.4)	2416 (64.1)	126754 (19.5)	19252 (18.5)	4002 (296.4)	1715 (-65.0)	1696 (-78.4)	1242 (-35.8)	2938 (-70.0)	8654 (-31.6)
1998-99	714025 (17.9)	N.A. (-)	N.A. (-)	N.A. (-)	104833 (21.8)	47124 (23.1)	3339 (38.2)	155296 (22.5)	22806 (18.5)	3090 (-22.8)	6552 (282.1)	2563 (51.1)	191 (-84.6)	2753 (-6.3)	12395 (43.2)
1999-2000	810065 (13.5)	N.A. (-)	N.A. (-)	N.A. (-)	N.A. (-)	N.A. (-)	N.A. (-)	N.A. (-)	N.A. (-)	16520 (434.6)	4374 (-33.2)	3230 (26.0)	101 (-47.1)	3331 (21.0)	24224 (95.4)

* Growth rates calculated on a year-on-year basis for 1994-95 and 1995-96 got distorted as last Friday of the year 1994-95 being a reporting Friday registered a huge deposit accumulation of Rs.20,161 crore. Based on average of monthly outstanding figures for 1994-95 and 1995-96, the growth rates worked out to 19.1 and 13.6 per cent, respectively.

**Based on new capital issues.

@ Data relate to scheduled Commercial banks.

Note: Figures within brackets represent percentage variations over the previous year.

NA - Not available.

Source: RBI, Handbook of Statistics on Indian Economy, 1999.

4.30 During 1995-96, the growth of bank deposits decelerated sharply to 12.1 per cent from 22.8 per cent in the previous year. However, during this year the growth rate of most of all other instruments also decelerated or registered a negative growth. Only LIC policies and deposits with companies registered a marginally higher growth rate in comparison with the previous year. The possible inference is that the deceleration of bank deposits during 1995-96 was due to overall deceleration in the savings.

4.31 During 1998-99, the growth rate of bank deposits again decelerated to 17.9 per cent from 19.7 per cent. During this year, investments in bonds of DFIs grew sharply by 282 per cent and small savings by 22.5 per cent as compared with -65.0 per cent and 19.5 per cent, respectively, in the previous year. The increase in small savings, in turn, was contributed mainly by Indira Vikas Patra (IVP), Kisan Vikas Patra (KVP) and post office monthly income scheme. The IVP and KVP increased by 27.3 by 22.3 per cent, respectively, as compared with increases of 21.1 and 18.7, respectively, in the previous year. Deposits in post office monthly income scheme increased by 36.2 per cent during 1998-99 on top of the increase of 48.5 per cent in the previous year. Other instruments either showed marginal increase or deceleration in the growth rate. Investments in mutual funds and in shares and debentures registered negative growth of 22.8 per cent and 6.3 per cent, respectively. The growth rate in LIC policies remained unchanged at 18.5 per cent. Thus, during 1998-99, it is possible that the deceleration in bank deposits was due to sharp increase in the bonds of DFIs and small savings.

4.32 Data for 1999-2000 are not available for all the instruments except bank deposits and capital market instruments. Available data suggest that the growth rate of bank deposits during 1999-2000 decelerated sharply to 13.5 per cent from 17.9 per cent in the previous year⁸. On the other hand, the growth rate in units of mutual funds shot up by 434.6 per cent (in comparison with negative growth of 22.8 per cent in the

⁸ The growth rates indicated are based on the last reporting Friday of March every year. As during the year 1999-2000, the last Friday of the year was not an alternate Friday for reporting purposes, data were available for one extra week, i.e., Friday subsequent to the reporting Friday. The growth rate worked out on the basis of last Friday of the year worked out to 17.9 per cent, which was the same as during the year 1998-99. However, banks normally resort to window dressing during last few days of the year. For this reason and for maintaining consistency with the data for the earlier years, data as available on the last reporting Friday (instead of last Friday) were used for the year 1999-2000.

previous year). Investments in shares and debentures also increased by 21 per cent (in comparison with decline of 6.3 per cent in the previous year), while investments in bonds of DFIs declined by 33.2 per cent (in comparison with increase of 282.1 per cent in the previous year). On the whole, all capital market instruments, combined together, grew sharply by 95.4 per cent during 1999-00 on top of the increase of 43.2 per cent in the previous year. This would suggest that deceleration of bank deposits during 1999-2000 could have been caused by a sharp increase in the investments in capital market instruments (Table 10).

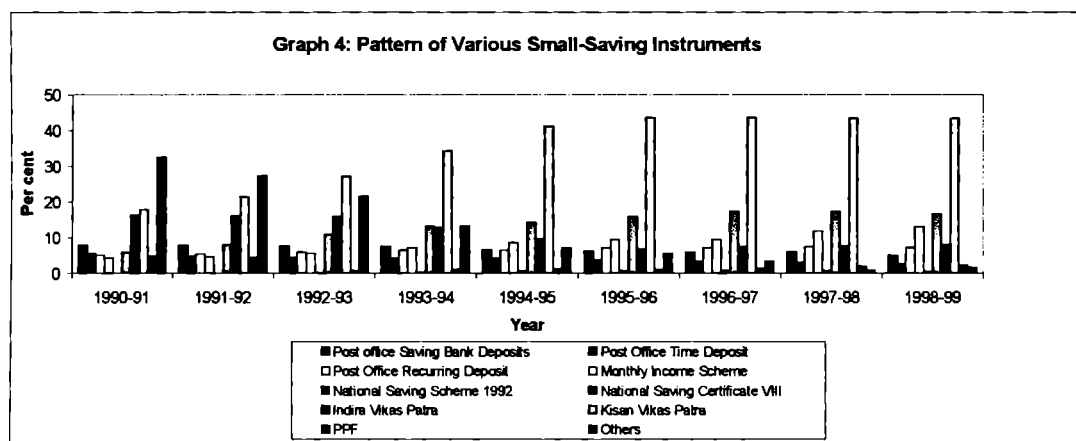
4.33 An analysis of individual data series from 1991 to 1999-2000 suggests that bank deposits at different points of time faced competition from different instruments, such as, NBFCs deposits, post office deposits and capital market related instruments viz., units of mutual funds, shares and debentures and bonds of DFIs. Thus, the analysis confirms the finding arrived earlier, based on the data on financial savings of the household sector that bank deposits during some years could have faced competition from other instruments, especially capital market instruments.

4.34 In this context, it is worth pointing out some significant changes which have taken place in the growth of various small saving schemes. While, on the whole, small savings during the period from 1991-92 to 1998-99 grew at a reasonable rate of 14.4 per cent, the growth pattern of various components was not even. While some of the components grew rapidly, some others did so at a very low or moderate rate.

4.35 During the 1990s, post office saving bank deposits, time deposits and IVP grew at a low average annual rate of 7.9 per cent, 4.8 per cent and 5.9 per cent, respectively. On the other hand, post office monthly income scheme, Kisan Vikas Patras and National Savings Certificates VIII grew at a very rapid rate of 31.7 per cent 28.2 per cent and 30.6 per cent, respectively. Post Office recurring deposits and PPF grew at a moderate rate of 19.8 per cent and 19.4 per cent, respectively.

4.36 As a result of divergent pattern of growth rates, the combined share of savings bank deposits, time deposits, national savings scheme, Indira Vikas Patra and PPF declined from 51.1 per cent during 1990-91 to 18.5 per cent by 1998-99, while that of recurring deposits, monthly income scheme, NSC VIII and KVP increased from 48.8

per cent to 81.5 per cent. In particular, the post office monthly income scheme and KVP became very popular during the 1990s (Table 11 and Graph 4).



4.37 The broad findings of the analysis, based on individual data series, are more or less in conformity with the findings based on financial savings of the household sector analysed earlier. The main points emerging from the above analysis are summed up below:

- i) The growth rates of all savings instruments showed wide year to year variations barring investments in LIC policies which showed relatively less variations.
- ii) The growth rate of bank deposits, deposits with non-banking non-financial companies, certificates, PPF, units of mutual funds and corporate debentures decelerated during the 1990s as compared with the 1980s, while that of NBFCs deposits, post office deposits, LIC policies and shares accelerated.
- iii) Of all the instruments, deposits with NBFCs grew at the highest average annual rate during the 1990s, followed by LIC policies, investments in capital market instruments, bank deposits and small savings.
- iv) Bank deposits showed a marginally lower growth (17.1 per cent) during the 1990s as compared with the 1980s (18.1 per cent). However, bank deposits showed a more consistent growth during the 1990s in comparison with the 1980s. Bank deposits also showed a more consistent growth in comparison with all other saving instruments (other than contractual savings) during the 1990s.

Of the components of bank deposits, while demand deposits grew at a marginally higher rate during the 1990s as compared with the 1980s, time deposits grew at a marginally lower rate. Savings deposits also grew at a lower rate during the 1990s. Although term deposits during the 1990s grew more or less at the same rate as during the 1980s, significant structural changes were observed in the relative importance of various maturities. There was a distinct shift of term deposits in favour of short to medium term maturity (6 months and up to 2 years).

- v) While, on the whole, the growth of bank deposits was not affected adversely in a significant way during the 1990s, there was an evidence to suggest that in some years bank deposits could have faced competition from alternative savings instruments, such as, capital market instruments (especially units of mutual funds), NBFCs deposits and post office deposits. However, there was no consistency or pattern in the competition faced by bank deposits, which was observed in different years and from different instruments.
- vi) The significance of post office monthly scheme, KVP and NSC VIII increased sharply during the 1990s, while that of savings bank deposits, time deposits, NSS and IVP declined.

4.38 The above analysis suggests that bank deposits at different times faced competition from different saving instruments. However, there are reasons to believe that, in comparison with other instruments, units of mutual funds posed a more serious competition to bank deposits. This was clearly evident during the year 1999-2000 when resource mobilisation by mutual funds increased sharply, while bank deposits witnessed a sharp deceleration. While tax incentives announced in the Union Budget for 1999-2000 and as detailed in Chapter 3, together with generally buoyant conditions in the stock markets [share prices (BSE Sensex) increased by 33.7 per cent during 1999-2000] helped enhanced the attractiveness of units of mutual funds, there were some other factors which also aided to their attractiveness during 1999-2000 as detailed below:

- (a) Open-ended schemes launched by mutual funds are very liquid. An investor can conveniently buy and sell his units at NAV related prices. During 1999-2000,

Table 11: Small Saving Schemes

(Amount in Rs. crore)

Year* (April-March)	Deposits											Certificates				PPF @		Others		Total		
	Post office Saving Bank Deposit		Post Office Time Deposit		Post Office Recurring Deposit		Monthly Income Scheme		National Saving Scheme 1992		National Saving Certificates VIII		Indira Vikas Patra		Kisan Vikas Patra		Amount	% to total	Amount	% to total	Amount	
	Amount	% to total	Amount	% to total	Amount	% to total	Amount	% to total	Amount	% to total	Amount	% to total	Amount	% to total	Amount	% to total						Amount
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	
1991-92	4619 (9.8)	7.9	2861 (-3.8)	4.9	3094 (17.3)	5.3	2720 (16.2)	4.6	- (-)	-	4709 (50.2)	8.0	9410 (8.0)	16.1	12591 (32.3)	21.5	2590 (0.04)	4.4	15995 (-8.1)	27.3	58595 (9.5)	
1992-93	4706 (1.9)	7.7	2715 (-5.1)	4.5	3626 (17.2)	5.9	3343 (22.9)	5.5	82 (-)	0.1	6640 (41.0)	10.9	9704 (3.1)	15.9	16478 (30.9)	27.0	466 (-82.0)	0.8	13188 (-17.5)	21.6	60948 (4.0)	
1993-94	5044 (7.2)	7.5	2933 (8.0)	4.3	4272 (17.8)	6.3	4802 (43.6)	7.1	211 (157.3)	0.3	8879 (33.7)	13.1	8759 (-9.7)	12.9	23208 (40.8)	34.3	660 (41.6)	1.0	8928 (-32.3)	13.2	67696 (11.1)	
1994-95	5504 (9.1)	6.6	3500 (19.3)	4.2	5320 (24.5)	6.4	7164 (49.2)	8.6	654 (210.0)	0.8	11866 (33.6)	14.2	7972 (-9.0)	9.6	34305 (47.8)	41.2	1027 (55.6)	1.2	6025 (-32.5)	7.2	83337 (23.1)	
1995-96	5814 (5.6)	6.2	3447 (-1.5)	3.7	6622 (24.5)	7.1	8895 (24.2)	9.5	652 (-0.3)	0.7	14851 (25.2)	15.9	6375 (-20.0)	6.8	40895 (19.2)	43.6	1028 (0.1)	1.1	5139 (-14.7)	5.5	93728 (12.5)	
1996-97	6362 (9.4)	6.0	3443 (-0.1)	3.2	7631 (15.5)	7.2	10032 (12.8)	9.5	768 (17.8)	0.7	18478 (24.3)	17.4	8065 (26.5)	7.6	46296 (13.2)	43.6	1472 (43.2)	1.4	3544 (-31.0)	3.3	106111 (13.2)	
1997-98	7667 (20.5)	6.0	3839 (11.5)	3.0	9262 (21.1)	7.3	14902 (48.5)	11.8	879 (14.5)	0.7	21998 (19.0)	17.4	9765 (21.1)	7.7	54951 (18.7)	43.4	2417 (64.2)	1.9	1074 (-69.7)	0.8	126754 (19.5)	
1998-99	7650 (-0.2)	4.9	4219 (9.9)	2.7	11139 (20.3)	7.2	20293 (36.2)	13.1	820 (-6.7)	0.5	25831 (17.4)	16.6	12430 (27.3)	8.0	67214 (22.3)	43.3	3204 (32.6)	2.1	2496 (132.4)	1.6	155296 (22.5)	
Average Annual Growth Rates (Per cent per annum) 1991-92 to 1998-99		7.9		4.8		19.8		31.7			65.4		30.6		5.9							14.4

* : Data are outstanding as at end-March of the respective years.

@ : Figures for 1990-91 and 1991-92 relate to SBI transactions only and for rest of the years relate to Post office transactions.

Note : Figures within brackets represent percentage variations over the previous year.

Source: Handbook of Statistics on Indian Economy, 1999, RBI.

open-ended schemes emerged as the preferred investment option, which can be gauged from the fact that, of the 64 schemes launched during the year, 61 were open ended. The fear of exit from open-ended schemes also made fund managers to continuously focus on maximising returns.

- (b) During the year, mutual funds introduced many flexible features to suit their investors' needs, such as, (i) allowing investors to switch from one scheme to another between various plans of the scheme, thus, allowing him to alter his investment mix depending on his needs and his return expectations, (ii) introducing customised products to meet specific investment needs, (iii) allowing transactions to be routed through the website, (iv) increasing the periodicity of dividend payments, monthly or quarterly, by debt funds, and (v) introducing sector specific funds, such as, Infotech Fund, Internet Fund to target the fast growth sectors and gilt funds and monthly income plans.
- (c) Remarkable performance of IT sector in the stock market also revived the interest in mutual funds industry. Many of those investors who failed to get an allotment of IPOs from IT companies appeared to have invested in mutual funds. This trend caught on during the second half of 1990-2000.
- (d) Debt funds launched by some of the mutual funds have become quite popular because of their tax-efficient returns. For instance, for more than 1 year, an investor needs to pay only long-term capital gains tax. Debt funds also provide easy liquidity to the investor as he can encash his investments within 3 to 4 days. Some funds do charge a fee (called the exit load) when an investor sells out within 6 months or 3 months of the entry. However, the penal fee is low and works out not more than 0.5 per cent normally. The easy liquidity of investments in debt funds has enhanced the attractiveness of units.
- (e) The general decline in the interest rates during 1999-2000 adversely affected the attractiveness of fixed income instruments. This, coupled with the fact that some of the growth schemes posted a high return of over 100 per cent and outperformed the benchmarks of fund's performance, such as, BSE Sensex, and NSE Nifty, also enhanced the relative attractiveness of units of mutual funds.

CHAPTER 5

SUMMARY OF THE FINDINGS AND SOME FINAL REFLECTIONS

5.1 The process of financial sector reforms initiated in 1992-93 has brought about significant changes in the Indian financial system. Three significant developments which helped enlarge the investor's choices of savings instruments were (a) the setting up of private sector mutual funds, (b) the entry of DFIs in the bonds market and (c) the increase in the number of NBFCs in the early period of reforms. Besides, there were some other factors which impinged on the risk-return perception of the investors. Various tax incentives announced from time to time also enhanced the relative attractiveness of some instruments. Liberalisation of interest rates on bank deposits, and the freedom given to them to determine penalty on premature withdrawals and offer floating rate of interests provided flexibility to banks to maintain their competitiveness.

5.2 These factors had had significant impact on the process of asset allocation. A detailed analysis of the interest rate structure, financial assets of the household sector, and the individual data series since 1990-91 revealed the following trends:

- (i) The interest rates available on various fixed income saving instruments were observed to be quite flexible and interest rates on almost all the fixed income instruments were found to be moving in tandem with the interest rates on term deposits of banks. However, the gap between the interest rates on term deposits of scheduled commercial banks and various saving instruments narrowed down during 1999-2000 in comparison with 1991-92. The convergence of interest rates offered on various saving instruments over the years eroded, to some extent, the attractiveness of bank deposits seen purely from the point of view of rate of return.
- (ii) All savings instruments showed wide year to year variations during the 1990s barring contractual savings which showed relatively less variations.
- (iii) Non-banking deposits grew at the highest rate due mainly to deposits with NBFCs.

- (iv) The importance of capital market instruments declined both in absolute and relative terms between 1991-92 and 1998-99, but improved sharply during 1999-2000 due mainly to accelerated growth in the units of mutual funds.
- (v) For the period as a whole, banks maintained their dominant position in savings mobilisation. In comparison with the 1980s, the average growth rate of bank deposits during the 1990s was only marginally lower. Bank deposits showed a more consistent growth during the 1990s in comparison with the 1980s. Bank deposits also showed a more consistent growth in comparison with all other savings instruments (other than contractual savings) during the 1990s. Bank deposits also grew faster than overall financial savings. The share of bank deposits in gross domestic savings also improved between 1990-91 and 1998-99.
- (vi) Some changes were also observed in the growth rate of demand deposits and time deposits. While the growth rate of demand deposits accelerated during the 1990s, that of time deposits decelerated. Although term deposits during the 1990s grew more or less at the same rate as during the 1980s, a shift was noticed in favour of short to medium term maturities (6 months and up to 2 years).
- (vii) While bank deposits maintained more or less their overall growth rate during the 1990s, there was an evidence to suggest that in some years bank deposits were substituted by units of mutual funds or shares/debentures or non-banking deposit or combination thereof. However, there was no consistency or pattern in the competition faced by bank deposits, which was observed in different years and from different instruments.
- (viii) In case of small savings, the popularity of KVP, post office monthly income scheme and NSC VIII increased sharply during the 90s, while that of post office savings and time deposits and IVP declined significantly.

5.3 Asset allocation is a complex process and is influenced by a wide variety of factors. In a developing country like India where income levels are not very high, safety becomes the utmost concern for the investor. It is, therefore, not surprising that bank deposits, small savings, pension and provident funds and LIC policies constitute the bulk of the domestic savings.

5.4 Bank deposits are traditionally the most preferred saving instrument in India. Although rate of return on bank deposits, of late, was found to be little on the lower side as compared with many other saving instruments, bank deposits continue to be the single most important form of savings due mainly to their safety, liquidity and convenience. However, the attractiveness of bank deposits *vis-a-vis* some other instruments could be eroding due largely to tax considerations. For instance, bank deposits are safe like post office deposits and both instruments also enjoy same tax benefits. However, interest income over Rs.10,000 received from a branch of a bank is subject to tax deduction at source. An investor, who is concerned with his tax obligations, may therefore, prefer to deploy his savings in post office deposits instead of bank deposits even as in all other respects both instruments have identical benefits. In terms of tax benefits, units of mutual funds and equity shares are now better placed as compared with bank deposits as the entire dividend income is now tax free received at the hands of investor. Given the fact that some of the mutual funds provide good liquidity, an investor with somewhat risk-taking behaviour seems to be preferring units of mutual funds instead of bank deposits.

5.5 It is significant to note that banks are conscious of the growing competition. After they were given freedom to fix their own interest rates, rules regarding premature withdrawal, etc., banks introduced many features and liberalised the rules regarding premature withdrawal. Some of the foreign banks, in particular, have simplified withdrawal from fixed deposits. Besides, some of the foreign banks are also offering up to 90 per cent of the overdraft facility with additional benefits, such as, ATM, Tele banking, etc. Some of the private sector banks also offer overdraft facility up to 75 per cent against fixed deposits. The nationalised banks are also offering some special schemes. Nationalised banks have two main advantages in the form of wide network of branches all over the country and the low minimum deposits required to run a fixed deposit account.

5.6 Although banks are expected to maintain their dominant position in the resource mobilisation, they face increasing competition from capital market instruments, especially units of mutual funds. While investors, in general, are risk averse, there are investors who are willing to take risk if the returns are higher. As

economy moves on to a higher growth trajectory and the level of incomes go up, more and more investors would be willing to take higher risk. In a declining interest rate scenario, even a risk averse investor could be tempted to go in for capital market investments in search of better returns. As mutual funds are efficient vehicle for diversifying the risk and are strictly regulated, they become a preferred choice of many investors. Therefore, the process of asset allocation, which is undergoing some change is expected to gather further momentum in favour of capital market instruments, especially units of mutual funds, in the future. Not much change is expected in the role of contractual savings, such as, insurance, pension/provident funds as also in small savings. The NBFCs are going through a consolidation and restructuring phase within strict regulatory framework and their clear role in savings mobilisation would re-emerge only over a period of time.

ANNEXURE I

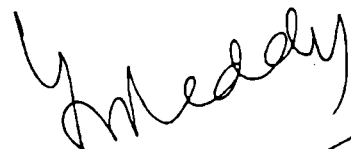
MEMORANDUM

Informal Group to Study the Role of
Bank Deposits in Savings Mobilisation

In the context of financial reforms undertaken, several financial intermediaries are competing among themselves for resource mobilisation. In this context, it becomes necessary to study their impact on the traditional banking sectors' resource mobilisation in particular the attractiveness of bank deposits and also to find out the relationships if any among these intermediaries and varied instruments. It has been decided that a Group may look into the various aspects of resource mobilisation by banks and other financial intermediaries.

2. Accordingly, a Group has been constituted with the following members:
 1. Shri A. P. Kurien, Chairman, Association of Mutual Funds in India
 2. Dr. Ajay Shah, Professor, IGIDR
 3. Shri P.P. Sastry, Chief General Manager, UTI
 4. Shri Kevin D'souza, General Manager (Accounts & Finance), BSE
 5. Shri Mahesh Thakkar, ED, Association of Leasing and Financial Services
 6. Dr.N. Nagarajan, Adviser, DEAP
 7. Dr. G.S. Bhati, Adviser, MPD
 8. Dr. D.V.S. Sastry, Director, MPD
 9. Shri Janak Raj, Director, CMD, DEAP (Convenor)
3. The Capital Markets Division of DEAP will provide the secretarial support to the Group.
4. The Group may have special invitees at their meetings. The Group will submit its Report before the end of June 2000.

February 12, 2000


(Y.V. Reddy)

Annexure II

Income Tax Benefits on Various Saving Instruments – Section-wise

Section-wise tax benefits available on various saving instruments under the Income Tax Act are detailed below:

Tax Rebate (Section 88 of IT Act)

Under Section 88, introduced during 1990-91, contribution to provident fund, the premia paid on life insurance policies, national savings certificates, unit linked insurance plan of UTI and LIC Mutual Fund, equity linked savings schemes (ELSS) of mutual funds are entitled to a tax rebate equal to 20 per cent of such savings subject to a maximum tax rebate of Rs.12,000. Contribution to ELSS has a ceiling of Rs.10,000 within the overall ceiling of Rs.60,000 for all the avenues covered by Section 88. Additional tax rebate of Rs.4000/- is available on shares/debentures of an infrastructure company. That is, by investing in shares or debentures of infrastructure sector, a higher qualifying amount of Rs.80,000/- and a tax rebate of Rs.16,000/- (i.e., 20% of Rs.80,000) can be claimed. By investing only in shares/debentures of a infrastructure company, a maximum rebate of Rs.16,000 (i.e., 20 per cent of Rs.80,000) may be claimed.

Till 1991-92 (assessment year 1992-93) deduction was allowed under Section 80CCA in respect of deposits made under the National Savings Scheme and payments made towards the notified annuity plans of LIC, like Jeevan Dhara and Jeevan Akshay. This deduction was provided on the entire amount up to Rs.40,000. This deduction was withdrawn from the year 1992-93 and from that year onwards contribution made under Section 80CCA Schemes are included for tax rebate purposes under Section 88.

During 1990-91 (Finance Act, 1990), Section 80CCB was introduced wherein the investment in equity linked saving scheme offered by UTI and other approved mutual funds up to Rs.10,000 per annum was totally exempted and deductible from total income with a minimum lock-in period of three years. However, amount in respect of minimum deduction allowed was subjected to tax at the time of encashment

after the lock-in period was over. Moreover, any appreciation on such units also attracted capital gains tax.

From the year 1992-93, the deduction is not available under Section 80CCB. Instead investments made under Section 80CCB are now included in the schemes under Section 88. As a result, while no tax at the time of redemption/repurchase in respect of which deduction was allowed is payable, appreciation continues to be subject to capital gains tax.

Exemption of Interest Income (Section 80L of the IT Act)

Interest income is taxable in the regular course and is clubbed with other incomes of the investor. Under Section 80L, interest income from certain specified investments [interest on government securities, interest on National Savings Certificates - VIII, National Savings Scheme, 1992, units of UTI and mutual funds, interest on post office deposits, interest on bank deposits, interest on co-operative society deposits (made by members), interest on deposits placed with approved industrial finance institutions and interest on deposits placed with approved housing finance institutions] are eligible for deduction from taxable income. The maximum deduction under Section 80L is Rs.15,000/- which includes a general deduction of Rs.12,000/- and a special deduction of Rs.3,000 on interest on any security of the Central Government or the State Government. Consequently, an investor can claim entire deduction of Rs.15,000 by investing in Government securities. Interest earnings exceeding Rs.2500/- p.a. (Rs.10,000 per annum in case of a bank) are subjected to deduction for tax at source. Section 80L ceased to have significance insofar as the income from units of mutual funds is concerned as it is entirely now exempt from income tax now.

Capital Gains [Section 48(2)]

Capital gains arise when a profit is made on transfer of a capital asset. Shares, units of mutual fund and listed securities, *inter alia*, are subject to the capital gains tax. Capital gains are of two types - short term and long term. Shares, units of mutual funds and securities are treated as short-term capital asset if they are held by the

assessee for 12 months or less and long-term capital assets if held for more than 12 months. Short-term capital gains are clubbed with incomes like Salaries, Business Profits, etc. Tax on short term capital gains would, therefore, depend upon investors' total taxable income and tax rates would be applicable as per regular tax slabs. Income from long term capital gains are taxed at a lower rate of 20 per cent. With effect from the accounting year 1993-94, the following two items are deducted to arrive at the long-term capital gains, viz.,

- (a) cost of acquisition as adjusted by the cost inflation index notified by the Central Government, and
- (b) expenditure incurred in connection with such transfer.

Indexation recognises that part of the capital gain that is sought to be taxed as a result of inflation. Accordingly, the cost of the asset is increased by a factor of inflation, to arrive at the 'indexed cost'. Cost of the asset includes improvement, if any, made. Sale price less selling expenses less indexed cost is the taxable long-term capital gain.

The 1999-2000 Finance Act allowed a concessional rate of tax of only 10 per cent in case of capital gains on listed securities. However, in such cases benefit of indexation can not be availed. The investor can, therefore, work out the two taxes, viz.; 20 per cent tax rate after Indexation and 10 per cent tax rate without Indexation. The lower of the two taxes will be levied.

Exemption from capital gains tax (Sections 54EA, 54EB and 54EC)

Long-term capital gains are treated as a separate block and with the introduction of Sections 54EA and 54EB in the Finance Act 1996, exemption on capital gains tax with a lock-in period of 3 years and 7 years, respectively, was allowed. Sections 54EA and 54EB provided for exemptions from long term capital gains where the investor was willing to block the funds generated from sale of long term assets in specified securities. These were notified by the government and *inter alia*, included shares, debentures, bonds of a public company or units of mutual funds. Under section 54EA, exemption from long-term capital gain was available if the entire proceeds from the sale of a capital asset were invested within six months. Such investments were subject to a minimum lock-in period of 3 years. Under Section

54EB, the profits arising from the sale of a capital asset were exempted if parked for a period of seven years.

In the Union Budget for 2000-2001, section 54EA and 54EB were removed and a new Section 54EC was introduced from April 1, 2000 whereby capital gains arising from transfer of a long term capital asset will be exempt if the assessee has within a period of 6 months after the date of transfer of long term asset invested the whole or any part of capital gains in long-term specified asset, i.e., in bonds redeemable after three years issued by NABARD or NHAI on or after April 1, 2000.

Dividend Income [Section 10 (33)]

Dividend received by investors from the companies are tax free. Dividends received from mutual funds and UTI are also tax free. Indian companies and mutual funds are required to pay a tax of 20 per cent on the dividend distributed. However, the receiving investor is not required to pay any tax. Open ended equity oriented mutual funds (with more than 50 per cent investment in equity) are exempt from such dividend tax of 20 per cent for a period of 3 years up to March 2002. However, debt-oriented schemes (with more than 50 per cent investment in debt) are subjected to 20 per cent dividend tax (plus surcharge) while distributing the dividends.