

Financial Reforms In India

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Introductory Remarks

- The world economy has very recently suffered the most severe recession since the great depression.
- Recovery is slow and fragile
- Some lessons:
 - Financial regulation can not afford to fall behind financial innovations and new business models.
 - Coordinated approach needed by monetary and fiscal authorities and supervisory agencies for effective supervision and for mitigating effects of any contagion.
 - Vigilance in striking the right balance between mederating risk taking and need for economic growth.

Post Crisis Economic Scenario

	2008-09	2009-10	2010-11(2Qrs)
Rate of growth of GDP(factor cost) %	6.7	7.4	8.9
Industry	3.1	10.4	10.3
Services	9.3	8.3	9
Agriculture	1.6	0.2	3.1
Export-GDP Ratio %	15.1	13.6	13.5
Foreign Exchange Reserves(Billion \$)	251.9	279.1	292.8(ES)
FDI Net (Rs Crores)	87734	89765	
FPI Net (Rs Crores)	-65749	153966	
Gross Corporate Profits to Sales %	13.2	14.9	13.7
Market Capitalisation (Rs Crores) EM	3086076#	6164157	

#Figure for 2007-08 was higher at Rs 5138015 Crores showing a dip in 2008-09

Problems Prior to Financial Reforms of Early Nineties

- 1 . Directed lending by banks and indiscriminate loan waiving
- 2 . Low capital base of banks
- 3 . Excessive regulation of interest rates and loans
- 4 . High SLR and CRR resulting in pre-emptive draft on bank- resources by the government
- 5 . Huge non performing assets with banks
6. Inadequate supervision
- 7 . No provisioning for bad debts
8. Minimal use of available technology
9. Sluggish activity in the stock market and government securities market.

Major Reforms in the Banking Sector

1. Most interest rates have been de-controlled. Banks given autonomy to set deposit and advance rates.
2. The new policy rates-Repo rate and Reverse Repo rate currently are at 6.5% and 5.5% respectively .Current SLR is 24% and CRR is 6%
3. SBI and other nationalized banks authorized and enabled to access debt and equity markets for diversifying their stock holdings.
4. Bank management granted autonomy ; no need for seeking credit authorization etc.
5. Board of Financial Supervision set up as an independent entity within RBI.
6. Banking Ombudsman for examining customer grievances.
7. Credit to Risk-weighted Asset Ratio, CRAR set at internationally acceptable standards. In fact on June 30, 2010 for all SCBs put together, actual CRAR was 14.4% while the Basel II norm is 10.5%
8. Private sector allowed to set up banks, mutual funds.
9. Foreign banks allowed to operate.

Current Profile of Banking Sector

RBI	No of Banks*	No of Offices*	**Deposits %	**Credit%
SBI & its Associates	7	16,570	22.5	23.1
Nationalized Banks	20	40,576	51.2	50.9
Regional Rural Banks	86	15,265	3.1	2.5
Other Scheduled Commercial Banks (Private)	22	9,112	18	18.3
Foreign Banks	34	279	5.2	5.2
Total	169	81,802	100	100

*Source: Basic Statistical Returns of Scheduled Commercial Banks in India Volume-38 March 2009

** Source : Quarterly Statistics on Deposits and Credit of Scheduled Commercial Banks Sept. 2010

Foreign banks in India

Comparative picture for 2008-09

	Rate of Return (%)*	Cost of funds(%)**	Other Income(%)***
Foreign Banks	9.9	4.2	121.1
Domestic Scheduled Banks	8.5	5.5	84.0

*Income on advances and investments as % of total advances and investments.

** Cost of interest on borrowings & deposits as % of borrowings & deposits.

*** As % of operating expenditure .

Foreign Investment cap in financial sector as in October 2010

Sector	Permitted Investment Level	Applicable Conditions
Asset Reconstruction Company	Up to 49% of paid up capital through govt. route	FII's not permitted to invest in paid up capital
Banking (Private)	Up to 49% Automatic, beyond 49% up to 74% through govt. route	Including investment by FII's
Banking (Public Sector)	Up to 20% through govt. route	Through FDI & FPI
Commodity Exchanges	Up to 49 % FDI through govt. route	By FII's

Priority Sector Lending

	Domestic banks (both public sector and private sector banks)	Foreign banks operating in India
Total Priority Sector advances	40 percent of NBC	32 percent of NBC
Total agricultural advances	18 percent of NBC	No target
SSI advances	No target	10 percent of NBC
Export credit	Export credit does not form part of priority sector	12 percent of NBC
Advances to weaker sections	10 percent of NBC	No target

Note: NBC stands for net banking credit operational from July 2009

Policy Rates and Ratios

	1991	2001	2010
Cash Reserve Ratio	15	8.5	6
Statutory Liquidity Ratio	38.5	25	24
Repo Rate		9	6.5
Reverse Repo Rate		7	5.5
Bank Rate	12	6.5	6.0
Base rate/PLR	16.5	12.0	8.5

Self-help Group Bank Linkage Programme

Year	No. of SHG Linked	Bank Loan (Rs Crores)	Refinance Assistance (Rs Crores)
1992-93	255	0.29	0.27
2001-02	197653	545.47	395
2008-09	1609586	12253.51	2620.03

Major Reforms in the Stock Market

1. Capital Issues (Control) Act repealed and Office of Controller of Capital Issues abolished. No need for prior sanction for fresh capital issues.
2. Security and Exchange Board of India, SEBI as a statutory body for regulation of stock markets.
3. Over the Counter Exchange of India, OTCEI , and National Stock Exchange established with nation wide online stock trading ,display made operational.
4. Both short and long sales to be disclosed at the end of each day.

Major Reforms in Government Securities Market

1. Ad hoc Treasury Bills phased out and replaced by Ways and Means advances.
2. Auction of Treasury Bills through open market operations
3. Establishing the institution of primary dealers in government securities with guidelines.
4. Liquidity Adjustment Facility (LAF) liquidity adjustment on an almost daily basis; Reverse Repos for absorbing liquidity and Repos for injecting liquidity. Repo rate and reverse repo rate provide a corridor for call rate and other short rates with repo rate as the upper limit and reverse repo rate as the lower limit.

Main Reforms in the Foreign Exchange Market

1. Flexible exchange rate; the impossible trinity of fixed exchange rate, central bank autonomy and capital mobility. India chooses to sacrifice fixidity of exchange rate.
2. Transnational capital controls dismantled with a small number of exceptions.
3. Foreign Investors allowed to access Indian capital market after registration with SEBI.
4. Indian companies allowed to raise capital abroad.
5. Foreign Exchange Regulation Act ,FERA of 1973 replaced by Foreign Exchange Management Act FEMA in 1997-98.
6. Rupee made convertible on current account. Substantial progress towards full capital account convertibility.
7. Capital gains tax on NRIs and FIIs rationalized.
8. Equity holding by foreign investors permitted in a large number of projects up to 100%.
9. RBI as the single window for receipt and disposal of proposals for overseas investment by Indian companies.

Need for Financial Reforms----Post Crisis Scenario

- Global financial crisis has unsettled the conventional model for the financial sector. A new urgency for financial sector reforms has set in in US UK and Europe, followed by search for optimal models for global co ordination and domestic financial reforms by the G 20.
- Macroeconomic management in Indian economy is reasonably balanced. No excessive current account imbalances; no excessive dependence on exports and no excessive leverage in the household sector, corporate sector or financial intermediaries.
- There is vulnerability of the macro-economy however, due to potential for shocks on four fronts viz. supply position of fuel and food, fiscal policy constraints and external finance.

Reform Agenda--Select Issues

1. Synchronised reforms in real and financial sectors. Housing Finance ---a case in point. Non-standardised housing-products, archaic tenancy laws, inadequate processes of price discovery—all these and many more issues need to be revisited .Innovations in housing finance to be fostered simultaneously and in sync with the requirements.
2. Tobin Tax on foreign exchange transactions could be considered. A proper recording of transactions in participatory notes . Disclosure of information must be made mandatory.
3. Green field FDI should be preferred.
4. During the recent financial crisis some NBFCs and Mutual Funds with close affiliations with large corporates showed extreme vulnerability in respect of liquidity. RBI did come to the rescue but in future RBI has to watch out for inter-linkages and for any conflict of interest which may have serious consequences.
5. Promoting policies of lending by banks for productive real sector activities like agriculture. small trade and industry rather than subscribing to further financialisation .

Issues Demanding Attention

1. Relative neglect of agriculture employing more than 52% of the total work force. Share of agriculture in total bank credit came down from 15.8% in end March 1990 to 10.9 % in end March 2009. Share of housing in total bank credit, went up in the same period, from 2.4% to 10%.
2. Combined CRAR of SCBs at 14.4% is higher than Basel II norm of 10.5%. But non performing assets of all banks at Rs 81810 crores in end March 2010 is pretty high indicating poor finances of some weak banks.
3. Competitive populism of coalition governments, absence of political consensus on critical issues, fiscal profligacy and inflation go hand in hand.
4. Need for monitoring commercial banks' exposure to stock market.
5. Inclusive banking though partly taken care of through priority sector lending by commercial banks. Banks supporting micro finance SHGs but monitoring essential.



Thank you