

## Y V Reddy: Banking and financial sector reforms - status and prospects

Comments by Dr Y V Reddy, Governor of the Reserve Bank of India, at the Panel Discussion on "15 Years of Reforms and the Road Ahead" convened on the occasion of "The Economic Times Awards for Corporate Excellence 2006-07" , Mumbai, 6 October 2006.

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Respected Prime Minister Sir, Shri Vineet Jain, Honourable Shri Chidambaram, Dr. Rangarajan, Shri Ahluwalia, leaders of industry and finance, and friends,

I am thankful to the organisers for according me the privilege of participating in this panel discussion.

My comments are divided into three parts – personal, present status, and prospects for Banking and Financial Sector Reforms.

On the personal front, I have worked closely with all the distinguished panelists here and hence, would like to publicly acknowledge my deep debt of gratitude.

I have been working with Dr. Manmohan Singh, our Prime Minister, in various capacities, starting in 1977 as his Deputy Secretary in the finance ministry and more closely since the initiation of reforms. Let me be very brief and say that I have always been inspired by his vision and guidance. I am grateful to him for the continued trust in me.

I have known Montek for about twenty-five years and had worked with him closely for sometime during the reform period. One is inevitably impressed with his sharp intellect and admirable articulation. We have been friends and have deep respect for each others' professional abilities.

Dr. C. Rangarajan is my guru – a guru in the true Indian tradition. He made me more of an economist than I could ever dream of. The conceptual framework and intellectual as well institutional foundations for the unique and impressive reforms in the monetary-fiscal, financial, and external sectors were laid by him.

His successor Dr. Jalan refined and nuanced the framework not only for taking these reforms forward but also for managing threats to stability. Dr. Jalan's contribution to exchange rate management is admittedly legendary.

I worked with Shri Chidambaram, initially, when he was the Commerce Minister and later when he was the Union Finance Minister. We continue to work together closely and it is a delight to have discussions with him knowing fully well that the outcome would be a better policy.

Shri Chidambaram is bold, decisive, and effective. Striking examples of these qualities are his decisions relating to gold liberalisation and the introduction of the system of the ways and means advance, which were the critical prerequisites for the evolution of money, government securities and forex markets.

I recall that when I joined as Governor three years ago, I emphasised the continuity and change aspects of the policy. This is a defining characteristic of the Indian reforms, which have been described as cautious. Shri Vajpayee, the then Prime Minister, and Shri Jaswant Singh, who was then the Finance Minister, supported this approach. Shri Singh provided strategic guidance and put full trust in my professional skills and judgment.

In fact, I believe that, over the fifteen years of reforms, all our leaders with their diverse backgrounds, and their varied qualities, have contributed to an economic policy in India that has given us some pride today and great hope for tomorrow.

On the present status of the banking sector, admittedly, there is scope for considerable improvement. Yet, its strength and resilience in ensuring growth and stability have been recognised universally. In the major emerging economies, we compare favourably in the services sector and are seeking to compete in the manufacturing sector while we try to catch up on the fiscal and infrastructural fronts. However, it is in the financial and banking sectors that we are unarguably ahead.

Our banking sector reform has been unique in the world in that it combines a comprehensive reorientation of competition, regulation and ownership in a non-disruptive and cost-effective manner. Indeed our banking reform is a good illustration of the dynamism of the public sector in managing the

overhang problems and the pragmatism of public policy in enabling the domestic and foreign private sectors to compete and expand.

Similarly, the financial sector of India as a whole exhibits vibrancy and resilience. The government securities, money and forex markets have significant public policy implications for a gradually-opening emerging market economy. These have developed during the reform period, with impressive diversification of participants and instruments.

The institutional, technical, and micro-structural aspects of the Indian financial sector are in alignment with the best global standards. Here, again progress achieved in financial sector is a testimony to the healthy evolution through mutual cooperation amongst government, monetary authority, regulators, and above all, diverse market participants – domestic and foreign, in public as well as in private sector.

Reflecting on future prospects in banking, immediate focus has to be on the cleaning up of the remnants of undercapitalised banks, while concentrating on improvements in the rural co-operative credit system. It is also necessary to ensure improvements in their governance and financial management. In the banking system as a whole, a healthy credit culture encompassing appropriate pricing, quality of service, financial inclusion and contract-enforcement would be vital.

While the larger corporates have already acquired considerable freedom in accessing funds from a variety of sources such as banks, non-banks, capital markets, and external resources, the small and medium enterprises, agriculture sector, artisans and the informal sector as a whole, remain to be demonstrably benefited.

For the way ahead, for the financial sector as whole, given the strong foundations and basic institutional framework, the issues relate to the pace of further deregulation and liberalisation, consistent with the progress of reform in the real and fiscal sectors. In practice, within the given legal framework, priorities have to be formulated to ensure implementation in tune with the evolving domestic and external developments.

The Reserve Bank of India has, in the service of our country, a proven track record and professionalism, which have lent it considerable credibility - both domestically and globally. This credibility enables the RBI to confidently carry the reforms forward to credibly maintain price and financial stability, while enabling self-accelerating equitable growth at elevated levels.

Thank you.