

## INDIA NOW HAS THE POTENTIAL TO SHAPE THE REVOLUTION OF THE GLOBAL FINANCIAL SYSTEM

## THE FINANCIAL CRISIS'S IMPACT ON THE DEVELOPING WORLD HAS BEEN VERY SEVERE



### Suman Bery

The economic thinker discusses India's economy with Ajit Jain

India's growth requires liberalization and reforms of the financial sector, says Dr Suman Bery, director general, National Council of Applied Economic Research, an independent Indian policy research institution. Bery, who has worked with the World Bank in Washington, DC, was in Ottawa two weeks ago to deliver a keynote address, as part of the International Development Research Center's India Lectures series, on 'India, Global Finance and the G-20: What lessons, what agenda?' He spoke to *India Abroad* about the way forward for India's economy.

**How has the global economic crisis impacted the Indian economy?**

There's an increasingly tight link between the domestic growth agenda in India and India's international role. In India, I think at least the thinking amongst liberal professionals is that the second generation reforms should include liberalization of the financial sector. While people might be willing to accept that in broad principles, but a great deal of debate as to what it consists of, what's appropriate, what's safe, and the developments in the Western financial system over the last two-three years have confused and complicated matters considerably — because there's no clear accepted role model any longer.

**Why are financial reforms an important part of India's growth agenda?**

There are two key shapers of the economic agenda in the country — [Indian] Prime Minister Manmohan Singh and Deputy Chairman of the Planning Commission Dr Montek Singh Ahluwalia. They have invariably argued that India requires liberalization and reforms of the financial sector for two-three reasons. Inclusiveness agenda: Even though we have a largely public sector dominating banking sector, the fact of the matter is that despite many attempts to

induce that sector to spread its reach to the poor in India, there's little progress in aging out the moneylenders and making institutional financing available to small farmers and tiny businesses in the country. And this is one of the reasons why micro financing system is needed. There's a fairly contentious and longstanding debate on what's the right kind of financial system, what's the right kind of regulatory system, what's the right kind of agenda for financial sector reforms and what's the right kind of pace for reforms that's appropriate for India's domestic development. Prime Minister Singh himself, when he visited the Reserve Bank of India sometime back, was actually and reasonably keen on faster pace, what economists call capital account liberalization. He has certainly been amongst the leaders who thought that international engagement on the trade side and the human side needs to be accompanied by integration with global finance.

**What's the right economic agenda for India today?**

The global economy was good in the mid 1990s and again in the middle part of this decade. There was a great deal of enthusiasm for faster opening up of the domestic economy to international finance. In the case of India, this has various dimensions. It will allow Indian corporations to borrow abroad and that part has been liberalized. Indian households should be allowed to invest abroad. India has been cautious on that. There has also been a question of allowing foreign banks to expand their presence in the Indian domestic market and that has been subject to a lot of lobbying by rich countries' governments. The RBI regulators have been quite cautious on that. Some of the other issues which are being discussed include fuller capital account convertibility. India now sits on the G-20 and as a result India now has the potential to shape the revolution of the global financial system of what the economists call the global financial architecture.

**What do the developing countries have to say about the global economic crisis?**

Not only the developing countries but even economists from developed countries, of the eminence of Joseph Siegel, have made the same argument. That, basically, the rules of the game of the international financial system, as it has evolved, have tended to be asymmetric without necessarily lot of upsides for the developing world, for the emerging markets. And what they would point at is the frequency of financial crises and financial questions essentially since the end of the fixed exchange rate in the mid 1970s.

**What's different in the present financial crisis?**

The financial crisis now is largely in the developed world and not in the developing world but its impact on the developing world has been very severe. Experts in India, China, Brazil, Indonesia, etc., — countries which have been invited to the G-20 — have to try and figure out what structure of international finance would make for safer globalization without turning the clock back and denying them. People at the moment tend to think the period of fast economic growth that preceded is something that would have happened. I don't accept that. Those people think we have had four-five years of very fast growth, including in India, and the easy availability of global finance was an important explanatory factor. But people would argue, myself included, that the volatility and the uncertainty is too high a price.

**Politically, Prime Minister Singh has emerged stronger after the recent Indian election. How would that play in terms of the economic reforms agenda?**

India's banking sector continues to be heavily dominated by government sector banks. The State Bank of India is in the ascendance because of the perceived flight to safety. I don't think it will last but for the moment the SBI group is riding high. The key issue facing the public sector banks is to generate sufficient capital for their growth. But the gov-

ernment, for fiscal reasons, feels constrained and restrained in subscribing additional equity. And yet the government wants to retain the majority stake in these banks. Many experts have suggested that the government ownership of the public sector banks should go down to as little as 33 percent and that these banks ought to be liberalized so that they could operate without public constraints and Central [federal] vigilance. Despite consensus amongst many experts, I don't think public ownership in the public sector banks will decline. Several statements of [Congress party president] Sonia Gandhi point to that also. But I believe there may be share issues by some of the public sector banks and no doubt people will see that as a good investment opportunity.

**What about constraints on the entry of foreign banks into India?**

It has been an important item on the agenda of some rich countries in particular — countries like the United States, Britain, etc. They want India to broaden its policies on functioning of foreign banks in the country that could allow free entry of those banks in India. But the RBI has been extremely conservative on this. And the official position in India is this has to be done on the basis of Western reciprocity and that India has made its commitment under the World Trade Organization for branch expansions by foreign banks. This reciprocity would be a kind of outcome because what has been happening in Britain, the US and Singapore is that the policy framework in theory is liberal but implementation of that through the actions of the regulators, etc, has been quite restrictive.

So, if the SBI and ICICI Bank are allowed to expand in Canada and the US, then banks from these countries perhaps would be allowed on a bilateral basis to expand in India. But their expansion wouldn't necessarily be subject to the discipline of the WTO.

**Is there any move in the Indian parliament to liberalize the banking sector?**

There was symbolically a bill introduced by then finance minister P Chidambaram before he was shifted to home affairs. That was for liberalizing foreign direct investment from 36 to 49 percent. There was no expectation that it would be passed as the Communist parties were still exerting all the pressure against such a move. Now, the Left has lost its clout in the recent election. So, I believe reforms at least in the insurance sector would proceed swiftly. The delay in making changes in this sector has actually helped to assure [State-owned] LIC and others that they can hold their own against others and that there's space for everybody, that the insurance industry is a very important element in support for the domestic equities and bonds markets.

**Are you optimistic about India's economy?**

I have always been optimistic. The Congress party will draw lessons from this election. That lesson may well be that, look I [Singh] have the populism in what it takes to return to power and that liberal policies have been discredited by the crisis of the West. So, I don't see an open field. I think in the financial sector, there will be continuation of caution. The Congress party will continue to brand itself as a center-left party more concerned with the common man. Many of the things that you and I might consider in the country's best interest are not necessarily shared by an average Indian. Privatization of public sector banks is not widely endorsed by the common man. Many headlines after the election results suggest that these are not something that the Congress party is going to commit itself. We all know Manmohan Singh's hands are now freer. All said, Prime Minister Singh is a very cautious man, a measured man and that may not change despite his enhanced political strength.