SPEECH

FINANCIAL SERVICES FOR INDUSTRY*

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It gives me great pleasure to be in your midst this morning. The setting is really beautiful. Not only is the setting beautiful but it is also symbolic. What can emphasise more the need for increased flow of trade and investment than a conference on the seas.

2. India and Britain are bound together by long years of historical association. This relationship acquired a new meaning with the emergence of India as an independent country. I believe we are now on the threshold of a new phase in our relationship — a phase of expanded and accelerated economic co-operation.

3. The United Kingdom has always been an important trading partner of India accounting for about 6.5 per cent of the total trade. The trade turnover was around $2.6 billion in 1992-93. Britain has traditionally been the largest foreign investor in India. In the last few decades, however, there has been a distinct slow down of British investment in India. I do hope that this trend will be reversed with the new bold Partnership Initiative. As they say, seeing is believing. I hope that all of you coming from Britain had enough of an opportunity to see the new mood in India.

4. India has come a long way from the crisis years of 1990-91 and 1991-92. The fiscal and balance of payments imbalances have to a large extent been controlled. These stabilisation policies have been supplemented by a set of structural reform policies covering many areas of the economy. The policy measures introduced since July 1991 have come to be commonly described as the New Economic Policy. There is a common thread running through all these measures and that is, to improve the productivity and efficiency of the system. The main thrust of the new economic policy is to impart greater competitiveness to the system as a means to improving the productivity and efficiency. This is sought to be achieved by removing the barriers to entry and restrictions on the growth of firms. While the changes in the industrial policy are aimed at improving the domestic competitiveness of the Indian firms, the changes in trade policy are aimed at improving the international competitiveness of Indian firms subject to the degree of protection offered by tariffs. The private sector is being given a large space to operate in. Some of the areas reserved for the public sector have now been thrown open to the private sector.

5. The structural reform policies have been largely in the areas of industrial licensing, foreign trade and investment and financial services. The system of industrial licensing has almost been given up. In the area of foreign trade, the emphasis has been on the removal of physical controls and the reduction in tariffs. Almost all quantitative controls on imports have been dismantled except in the area of consumer goods. In two successive Budgets, the tariff rates have been brought down substantially, even though our tariff rates may still remain high. Reduction in tariffs though desirable by itself, does create certain problems when simultaneously efforts are on to contain fiscal deficit. The customs duties do constitute an important source of revenue to the Government. While the medium term goal is very clear, we need continually to balance one objective against the other. There has been a sea change in the policy towards foreign investment. Many of the irritants have been removed and judged by the approvals for investment given by the various agencies in Government, it appears that there has been a good response. The total approvals granted upto the end of September 1993 amount to $ 4.3 billion, even though it is estimated, that only about 18 per cent of the value of approvals have resulted in actual flows. The actual flows have thus been modest. We do hope that these various approvals will be converted into actuals very soon.

6. In the area of portfolio investment, 113 foreign institutional investors have been permitted to invest and under this scheme since

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January 1993, the net inflow is reported to be around $ 418 million. It may be of interest for you to note that 50 out of 113 foreign institutional investors are from the U. K.

7. The new foreign trade regime has been supported by far reaching changes in the exchange rate management. In quick succession, the EXIM scrip scheme was substituted by the dual exchange market mechanism which in turn was substituted by a system of unified market determined exchange rate system at the beginning of March 1993. The exchange rate is now determined by the forces of supply and demand. The system has functioned remarkably well since its introduction and the rupee has remained very stable. This period has also seen a build-up of foreign exchange assets of the Reserve Bank and the reserves now stand at about $ 8 billion. Since April 1993, the Reserve Bank has bought $ 5.5 billion while it has sold $ 1.4 billion. The net purchase has thus amounted to $ 4.1 billion and these purchases have enabled the RBI to improve the quality of reserves. The volatile components such as swaps have declined substantially from the level at the end March 1993.

8. The Indian financial system has grown over the years. It comprises of an impressive network of institutions, instruments and markets. The extension of banking and other financial facilities to a very large cross section of the population stands out as a significant achievement. Despite the deepening and widening of the financial system, questions have been raised about the viability and the performance of banks. The present predicament of the Indian banking system is the result of a combination of factors both internal and external and financial sector reform proposals are meant to address both these factors.

9. The financial sector reforms fall broadly in three categories — (a) removing the external constraints operating on the profitability of banks, (b) improving the financial health of banks and introducing greater transparency in their balance-sheets, and (c) injecting a greater element of competitiveness in the system. The external constraints in the form of high levels of cash reserve requirements and statutory liquidity requirements have been considerably relaxed in the recent years. The administered structure of interest rates has also been simplified with only 2—3 rates being determined. In improving financial health of banks, an aggressive recapitalisation programme has been started; stringent norms relating to income recognition, provisioning for bad and doubtful debts and capital adequacy have been put in place. In introducing greater competition in the system, guidelines have been issued governing the setting up of private sector banks. 'In principle' approvals for 5 such banks have already been issued.

10. In the setting up of new private sector banks, collaboration with foreign financial institutions will be permitted and the extent of equity participation will be limited to 20 per cent. NRI's will be allowed equity participation upto 40 per cent. Foreign banks will continue to play their role in India. Today 57 foreign banks from 21 countries are operating in India with 141 branches, 24 representative offices and 14 agency arrangements. Negotiations on the service sector including financial services are currently under way as part of the Uruguay round of negotiations. In any framework that emerges in relation to the financial services, there should be no dilution of the MFN obligation.

11. The Indian economy is on the move. No other developing country in the process of adjustment has had a record of economic growth that India has had. In 1992-93, the growth rate of Indian economy was 4.2 per cent and it is expected that in the current year, the growth rate will be around 4.5 per cent. We do expect a pick-up in industrial production in the current year.

12. The balance of payments situation in 1993-94 will be manageable and perhaps the current account deficit will be substantially lower than in the previous year. However, it is clear that to sustain a viable balance of payments position over the medium-term, India's exports need to grow in volume terms between 15 and 20 per cent per annum. I do hope that the international environment will be conducive for India to achieve this goal.

13. We are living in an increasingly inter-dependent world. Trade and capital flows have become integral part of the world scene and these flows are seen to be mutually advantageous. It is indeed gratifying to note that a large British delegation has come to India. It is a measure of your earnestness and interest. Let us hope that these deliberations will lead to a rapid growth in the trade and investment flow between our two countries.