

Reflections on India's Economic Development [Rush Transcript; Federal News Service, Inc.]

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Council on Foreign Relations

FRANK G. WISNER: Ladies and gentlemen, good morning. It's a pleasure to welcome all of you to the Council on Foreign Relations this morning, and a chance to talk with and get to know India's very distinguished Reserve Bank governor. It's a privilege for me personally, having been a long-standing admirer of the governor, and being in business. All of you who know India will remember that there virtually is not step you take wisely in India without understanding and having a close relationship with the motor wheel of India's finances, the Reserve Bank.

Governor, to you, sir, a particularly warm welcome. From those who are drought-stricken, thank you for bringing the rain. We're very pleased. And I am delighted that you are with us.

Ladies and gentlemen, you have before you today in Governor Reddy one of the great figures of India's finance, a figure of international standing, an educator, and a terrific public servant throughout your life. I believe many of you have had a chance to read the governor's biography. There isn't a field of India economics, government economics, that you, Governor, have not touched: the Finance Ministry, the Commerce Ministry, and your own native state of Andhra Pradesh. I'm also delighted that you bring to this table today international experience from your time both with the World Bank and the International Monetary Fund. But if I stand back and think about you and your career, I remember that your great contribution has been your years in the Reserve Bank, both as deputy governor and now as governor since 2003. And it is true to say that every important aspect of the Reserve Bank's responsibilities you have been directly responsible for, from inflation, foreign exchange management, debt management, every field has been in your grip.

I don't have to tell all of you what a role the Reserve Bank plays in India's life, by statute, by tradition, and most of all by the extraordinary professionalism and respect with which the cadre of the bank and its leadership has forged the institutions over the years; its independence, its responsibilities, therefore, in the classic fields that we ascribe to a reserve bank, central bank, of keeping a sharp eye on the performance of the economy, on the monetary policies of India, on inflation, and on the inflation factors. But also, Governor, you play such a critical role in the management of the financial markets, their health, and in financial institutions. I know as well, given your experience, that you watch very carefully what is going on in the international scene.

I am really pleased, therefore, that we will have a chance to talk to you this morning and listen to you.

For those who might not have seen it, Governor Reddy has prepared a very thoughtful paper, which is available at the front desk. If you didn't pick up a copy coming in, I suggest that you do so when you leave.

The governor and I will speak for a few minutes, and then we'll turn the floor over to you for questions. I would ask you to all please respect Council rules. The session today is on the record. But when we come to questions, I would be—I would appreciate those who would like to ask a question when you do so, please identify yourself. Would you also all do the obvious and turn off cell phone or other electronic devices?

Governor, again, a very warm welcome from me to an old friend, and from all of us who are doing business in India, terrific respect for you, your career and the institution you're responsible for.

Governor, I thought that we would proceed, as you suggested, directly into an exchange. And I'd like to start with a rather broad question. There isn't one of us who's gathered together today who isn't struck by the fact that in the last several years, India has really emerged. The economy's taken off. And we're all struck by the fact that not only growth rates are high, but this time we look like we're in a for a good, long cycle of sustainable growth at high levels that is going to profoundly transform not only the nature of the Indian economy, but will have its world impact.

And I wonder if you could set the stage for us. Why now? What has happened to spark this move? From the position you sit in, how has India moved to emerge at this moment in world economic history?

Let me start with that and give you an easy one. (Laughter.)

Y.V. REDDY: Thank you. Thank you, Ambassador Wisner. I am most grateful to you, Sir, for your very, very kind remarks. I will do my best to explain whatever I can, and at times, I will share my confusion with you, frankly, since I know that I am among friends. Being among friends, one can be free and be frank, I believe.

When this issue came up and somebody said, "How is it that India is growing so fast in the recent years?" So I said, "There's a combination. There is an acceleration of growth and also acceleration of interest in India." So we are being noticed more now than before.

It is actually not very recent; if we see the growth pattern, the growth has been 6 percent from 1980. During the whole of 1980s, GDP grew at 6 percent. But the difference between the growth in 1980s and growth in 1990s was that in 1980s, there was only domestic liberalisation, and in a way, it was not sustainable because the debt was high, and there was inadequate incentive framework in the economy.

As a result, there was the debt and oil triggered crisis in 1991. So in 1990s, what we did was to make sure that the 6 percent growth was maintained on a sustainable basis. That is the main difference between 1980s and 1990s. In the 1990s, the growth process became sustainable both because of appropriate macro policies and also external liberalization. Having done some domestic liberalisation in 1980s, the external liberalisation in the 1990s, and having set right the macro policies, particularly on the exchange rate issues, in the 1990s we continued at 6 percent, but slightly accelerated.

Another thing that has happened in the 1990s is because of gradualism, both the public sector and private sector within India got their act together, and they were able to equip themselves to be globally competitive after a period. So by the time we reached the new millennium, the domestic public sector and private sector institutions, policymakers had the mental makeup and the skills to be able to go on an accelerated path of around 8 percent.

So the way I look at it is, it is an acceleration through what I describe as changing balances. It is not a dramatic move, but the balances keep changing so much that the changing balances reinforce the path of reform.

That's how I would describe the Indian growth process.

WISNER: It makes sense, it really does.

The point I conclude myself is that what we're looking at today, given the changes that you described, is a sustainable path, that we're going to see relatively high rates of growth for years to come. And therefore, in terms of those in the market who have to calculate risk, this is a sensible one. But no one is risk-free.

Could you think out loud with us for a moment, Governor, about what you think will be the major issues in the years ahead? What will be the tough problems that India will face that will affect her performance?

REDDY: I start with the major strength. The major strength of reform in India is that the reform is in some senses bottoms up. The decentralised private sector units and even the decentralised political units are into the mainstream. And you

will have noticed yesterday's elections in West Bengal, the chief minister who has been advocating reform has been elected with the higher majority in a state like West Bengal.

WISNER: And he's a communist.

REDDY: Yes, indeed. So that gives a signal of popular backing for the basic logic of reform. So in that sense, the reform process is deep-rooted and it is bottoms up, which gives the strength way forward.

However, the issues I would divide into global and domestic.

As far as global issues are concerned, first is the oil. So far, we have been able to handle the oil issue reasonably well because we are a growing and resilient economy. There is a price to be paid which we are paying. But still, the growth is respectable, so I think that is worth noting.

The sudden unwinding of global imbalance is unlikely, but if any disorderly unwinding were to happen, while we cannot be immune from it, our own analysis of the balance sheet shows that the impact will not be as serious as in the case of many other countries in this respect.

So the third issue which is sort of - which is occasionally there - is the issue of growing protectionism in the context of global imbalances. But that is a matter on which we cannot speculate at this point of time. We have to proceed in the assumption that we will always work together because it is in the mutual interest.

Having said this from the global perspective, in terms of the domestic issue, I would rate development in agriculture as the most critical issue way forward for two reasons. One, agriculture, which is growing at 2 percent so far, though it accounts for around 20 percent of GDP. If we want to reach the double digit in GDP growth, we have to focus on agriculture. There is a second and more important reason - that is about 60 percent of the workforce is dependent on agriculture. During the recent years, agriculture has been growing at 2 per cent, the population is growing roughly at 2 per cent, which means living standards have tightened for 60 percent of the workforce. And this has been happening for years. So it is not going to be easy to proceed with this type of situation without considerable feeling of deprivation.

So the way one has to look at it is a combination of development of non-agriculture sector, which will absorb some workforce, but certainly strengthening of agriculture. Enhanced investments - accelerated public investment, accelerated private investment - and changes in the institutional setting for agriculture will be the biggest challenge and most difficult. So it is agriculture, this is one reform which should be enabled by the strength we have in non-agriculture so far, and which should be developed in the interest of sustained stability, both economic, political and even social. I will put that as number one.

The second is the fiscal. The fiscal situation is not on the fast track. However, we have to recognize two important areas which will result in what I call fiscal empowerment. The main difference is, given the nature of the society and the large number of poorer people who are inhabiting the country, and the importance of education, health, public health, we have to incur expenditures on appropriate sectors in terms of quality, which is basically public health, education, governance, etc. So in order to be able to do that, fiscal empowerment, in my view, which we have used this word in the Reserve Bank publications, will need two things. One is elimination of subsidies which are not appropriate, and elimination of tax exemptions, which are distortionary. I think if we combine these two, then we should be able to arrive at a very strong fiscal position. The direction so far is satisfactory. And from a central bank point of view, I will rate this as the second most critical aspect.

The third, which is well recognized by most of you, and anybody who visits India will be struck by it right away, is improvements in physical infrastructure. There the big issue is the regulatory framework, and I believe the government is addressing this issue

So I will say that these three would constitute the major challenges for the medium term. It may not be exhaustive, but these three appear to be the most important, from my side.

WISNER: No, they certainly are. I'd take you back for a second to the fiscal position. India today, if my memory is correct, has an extremely manageable external debt position, but the internal pressures of fiscal expenditure are considerable. I don't remember the exact figure, 80 percent of GDP, the domestic debt. Is this really manageable? Are tax receipts rising? Is the economy going fast enough so that the domestic debt does not weigh on the performance of domestic financial markets?

REDDY: I think your memory is absolutely right, it is about 80 percent. One redeeming feature is that the GDP growth is around 8 percent and the fiscal deficit of the states is coming down, which is one good news in terms of numbers incrementally. And as you know, fiscal is one of those positions - and I am sure most of you know - the fiscal correction is a sensitive medium term issue. So handling stock, in a way, is going to be a medium-term issue, partly by the growth that is happening, and partly by incrementally handling this problem. But the stock also has an impact, as you rightly think, in terms of the forward movement in reforms in both external sector and financial sector.

The most important thing, we believe, in Indian policy situation is - I already mentioned the changing balances - what I would call as harmony, so there is this broad harmony between real sector, the fiscal, financial, external, governance institutions. If one was too fast in one way, and the other parts are left behind, there is the potential for imbalance. So in that sense, while the fiscal situation has never been a problem of threatening stability - it does not threaten stability - but it has constrained the growth prospects.

More recently, one of the main reasons we have been able to grow faster is because the private sector has been able to grow. Apart from deregulation, the resources made available by gradual reduction in the preemption of resources by the government, on the one hand, and the capital flows, on the other helped. So on both counts, we have had some relief, and according to our calibrations, with government on the Fiscal Responsibility Budget Management, fiscal situation will be on a sustainable basis by 2009. And we, the central bank, have been assured by the government of India that they will deliver consolidation by 2009. And many state governments have passed similar legislations. A few are on the way. So, personally and institutionally, we are confident that we would complete the process of fiscal consolidation by the year 2009-2010. And before that, we do not expect any issue arising, but we have to make sure that there is a harmonious liberalisation among various components of the macro-economy.

WISNER: Governor, that's encouraging, a very encouraging signal.

Let me take you to one other of the observations you just offered us, and that's the issue of infrastructure. Many people in this room will be looking at choices to make in financing capital flows to India, and India today faces, as you correctly noted, a daunting prospect in transportation and in power development and in the improvements in urban infrastructure that are so very clearly on your horizon.

Government is talking increasingly about public-private partnerships. How should we understand the concept of public-private partnerships and where we in the private sector responsible for financial flows should be thinking of our role in this partnership?

REDDY: Traditionally in India, we have had strong or perhaps virtual monopoly of our public sector and over much of the infrastructure. Now, when we move, given the totality of the situation, including many rights and privileges which accrue to various participants, dramatic shift to the private sector will be problematic though that was attempted in some states; and it was felt that it is good to combine the public policy assurances with the managerial and technological capabilities of the private sector. That is the type of mix we have opted for. One of the major issues of concern very often has been the type of costs we recover here. So once there is a public-private partnership, it will be possible to invoke many of the public policy measures to ensure cost recovery.

So therefore I think this type of overhang problems as well as the values of the public policy issues are managed and facilitated by public-private partnership. So inevitably where we are moving - and again I repeat the issue of changing balances - we are moving from a public monopoly, through public-private partnership, on to greater role for private sector.

So it is a way of - I would like to clarify - it is a way of gradual vacating of public sector. The public-private partnership is not meant to reinforce public sector. That I would like to clarify.

WISNER: Governor, we perhaps can come back to the details of that in a moment, but inherent in your remarks so far this morning has been a very optimistic—and correctly so—view of the pace and direction of economic reform, of government's decisions to encourage market forces to play their role, government to move back, to allow the private sector in India and its foreign partners to be front and center.

Raise the curtain for us. Look down the road over the next couple of years. India's also an intensely political land, where change must come about on a consensus basis. What would you predict will be the most important reforms that we could anticipate in India over the next several years? Where will the changes be?

REDDY: First, in terms of macro-aggregates, we are already touching domestic savings close to 30 percent and it is been gradually increasing. Both in terms of growth and investment, we distinguish ourselves in macro-efficiency as compared to many other Asian countries. So that process is likely to be strengthened. And the second thing is, in that sense, if we are looking at the growth prospect for India, yes, 8 percent seems to be very possible, and acceleration should not be ruled out.

As far as the stability is concerned, I will again dwelve into political, overall economic and financial stability.

In terms of political, the political system's stability, as you will note, this difference between political stability and political system stability. Any Party A or B may or may not be in power now or before, but together, every political party in India has been a part of central government or has been a part of state government. So the political system stability is the second dynamic factor.

The third dynamic factor and that with particular relevance for foreign investors is increasing enthusiasm of the provincial governments to attract foreign investments. There is a competition among the provincial governments to attract private investment so that they will be able to ensure physical infrastructure and good governance.

And therefore I will say the biggest, the most important reform that is likely to happen in the next few years will be at the state level, and that if you are looking for a tipping point for India's economy, my personal view is, tipping point will happen in the northern states of Uttar Pradesh and Bihar and as you will notice from the recent elections in East also.

So once these states move which have lot of people and have a very strong demographic dividend in the next three decades and there is an awareness among the state governments there is a tipping point. So if one is looking for the tipping point as far as India is concerned that will occur in states of Bihar and Uttar Pradesh. The growth of north Indian states start going up is key, because

the reform and the public-private partnership and understanding is pretty well-rooted in the south, is well-rooted in the west, and there is a beginning in east.

So I would say that in terms of the sectors, immediate priority is infrastructure and in the next two to three years, the financial sector and the real economy - the financial sector will follow real sector now. First priority will have to be infrastructure, which includes physical infrastructure, and followed by the real sector, I would say, would perhaps be the sequencing.

WISNER: Respecting the fact that you are India's chief regulator of the financial sector, can you, within that constraint, describe how you see changes will occur in the financial sector, in the banking sector, in other aspects of the financial sector? What should we anticipate?

REDDY: I would say in terms of priorities, insurance sector will have to grow (laughter), because of the simple reason that given the extent of economic activity, demographic situation and the huge workforce getting in, we have actually no insurance worth the name until recently. So it is one area where there is maximum convergence between the global interest, global expertise and the domestic requirements. I would place insurance as number one.

Second will be pensions. The pension is virtually restricted to government, the organized sector, which covers barely about 6 to 7 percent of the workforce. And then the way we look at it now is, there is increasing self-employment that is happening in India. The growth of services sector also is an indication of the number of self-employed people, and we do not have much of an institutional mechanism of insurance for that.

The third is that there is a convergence between the way the funds shall be raised from insurance and pension, because there's some sort of long-term contractual savings. They will fit in beautifully with the current requirements for financing infrastructure developments. So I would say that these two will have to be, and they are, on the priority item.

As far as the banking sector is concerned, I now say we are quite lucky in the sense that we have a number of foreign banks, and they are doing an outstanding job in terms of contributing to our financial sector development. Well, the foreign bank branches account for 7 percent of the banking assets in India, but they account for 60 percent of the off-balance-sheet exposures. They account for over 40 percent of the foreign exchange markets, both for the customers and inter-bank, whereas they account for only 7 percent in terms of all assets. Even government securities market which is very important for us, and this is the beginning of development of a corporate debt market in secondary market, foreign banks' share is about 25 percent. And there we are talking about 250 branches out of 80,000 domestic bank branches.

So the way it is happening is that among the foreign banks, one branch can do all that a domestic bank can do and is providing a necessary competition to

sectors where we have developed, and where the foreign banks have expertise. And one good thing that has happened is in the process, the public sector banks, in terms of efficiency, also have increased. So we are inter-active and we have given the road map also, and I think, well, within the medium-term, ideally, expect a lot more competition, a lot more diversification of banks' presence in the financial sector.

WISNER: Terrific.

Governor, I could pursue you with dozens of questions and exhaust all the time, but I really feel it's right if we share the conversation with audience at large. And I invite all of you to join in and give me your questions, and I, in turn, will steer them to the governor.

Do I have a first volunteer? Grand. In the very back of the room.

QUESTIONER: (Name and affiliation inaudible.) Good to see you again, governor. Just to press you a little further on a point you touched on with respect to the role of foreign banking institutions and the current level of the assets that they own. There is an increasing desire to be able to expand beyond the 7 percent. I would be interested in your thoughts on certain of the restrictions on some of the well-known positions seeming to come from your office, with respect to the capacity of foreign banks to expand beyond the 7 percent.

Thank you.

REDDY: Thank you very much. The way I would look at it is that the Indian situation has to do with reference of the quality and the context. The number of branch licences being given in India are more than our WTO commitments. The most important is qualitatively and I would say - I am confident to say and I have said that - qualitatively once a branch of a foreign bank is established in India, there are no restrictions on the type of business. In many countries, there is a restriction known as geographical restriction, whether it is written in the policy or not. In some countries, domestic currency operations are not allowed, and in most of the countries, the process of getting a branch license is also not easy.

But I can fully understand the desire, and I feel it is a compliment, that there is so much of enthusiasm about India. And in fact, yesterday, I was having discussion with our own bankers. So always - all commercial banks globally have the feeling of a little frustration, when they are turning into very attractive markets. So it is good that we find interest in India and we will make sure that the interest will continue. The return on asset in India, understandably, at about 3 percent for foreign banks; is perhaps among the highest in the world. And so I appreciate the interest, and that will be taken into account.

WISNER: Good.

Right here, left table.

QUESTIONER: Thank you.

Lyndsay Howard, the Dilenschneider Group. Sir, India has in the world an almost unique repository of knowledge on agricultural reform experiments, even though it is one of the most challenging issues. I wondered if you could address for us both in the global context and in where the U.S. can be helpful, how you see agricultural reform proceeding now, particularly in its efforts to both create sustainable development as well as poverty alleviation, and to relieve farmers in so many regions of the devastating effects of inclement weather. When there's good weather, good crops; when there's not, not.

REDDY: Well, thank you very much.

As I said, I will be cautious in covering real economy issues. I always fear if I cover real economy, then I'll find the real economy economists, possibly intruding in the central bank. And if I cover too much of fiscal, then the fiscal authorities will make inroads into monetary policy! (Laughs.)

So, having said that, I must recognize that we have a role to play. I don't want to explain how agriculture development should happen in India. But what should the RBI do in the context of agricultural development. One, our studies show that the major instrument for credit to agriculture is cooperatives. And the cooperative institutions which provide credit, have become very weak and just not able to deliver the credit. So there was a virtual institutional breakdown as far as agriculture credit is concerned and, therefore, the government of India recently appointed a committee to revamp the system. The Union budget has provided a little less than 1 percent of GDP to revive the cooperative structure, and there is a committee which has been appointed, with me as the chairman, to coordinate with the state governments to revive the cooperatives. That's the first issue.

The second issue is, in spite of the progress so far, the single-largest source of financing for farmers is informal sector - money lenders. We thought that it is necessary to analyze, therefore, we have just constituted a group to analyze the money lending legislation. This is also related to the issue of suicide of the farmers - sad - it's just hard for everybody.

So there are two other things we are doing. One is to study the money-lending legislation and see how far we can rationalize the legislation and implement it so that it is fair to the people who are lending and fair to the people who are borrowing, and bring it into a more formal system. The second area we are trying to improve is cooperatives. And the third, having done all that, we also require on the one hand greater penetration of insurance sector, and in that we have failed so far, but we have to do something about it, and that is being attended to. In the process, ultimately there is a need for mechanism by which we can help distressed farmers. These are the areas which are engaging our attention. But I think both from the Central Bank's point of view and the government's point of view, the provision of credit to agriculture directly and indirectly in terms of input

as well as output processing are also critical. These are priority items, and the Reserve Bank accords highest priority to that.

WISNER: Excellent. Good.

Manfred.

QUESTIONER: (Inaudible)—financial sector, Malaysia. Governor, how you see the evolution of the India-China economic commercial relationship? To what extent do you view it as competitive? And to what degree do you regard it as complementary?

REDDY: I would generally put the policy approach of India in the global context. And I think by and large, the Indian economic policymakers have never visualized policies in a national competitive sense. I think given the cultural diversity, the democratic processes, the basic effort has been somewhat to see how growth occurs and how the issues relating to poverty are taken care of. So that has been the major focus.

So the bilateral relation and multilateral relations in some senses have to fall into this bigger picture. But the fact remains that in terms of our relationship with Asia in general, and China in particular, trade is increasing, trade is increasing at a very rapid pace. So trade integration is occurring and is bound to occur, as I see it.

As far as the process in the global economy is concerned, the main drivers of growth in recent years continue to be the USA, China, followed by India.

So you know, therefore, the relationship between China and India is close, getting closer in economic terms. And I expect the same thing will continue as part of the cooperation along with competition in a global economy situation.

WISNER: Excellent.

Boyd, you're at the front table.

Gentleman.

QUESTIONER: Mohit Sudhakar from Freddie Mac. Governor, in terms of the growth of India's surpluses, that's a happy consequence of the growth in GDP. And as we see this growth of surpluses going on in the foreseeable future, how do you see these surpluses being managed?

WISNER: Yes.

REDDY: Let me first put the issue of surplus in the context of the global situation.

In the context of the global situation, we are not contributing either positively or negatively to the global imbalances in terms of large current account surplus and large current account deficit. So, in fact, we have been generating a modest

current account deficit of about 2 percent, which is reasonable. And the saving-investments have been by and large balanced. And significantly, the economy is domestic demand-driven, and therefore our policies, including exchange rate are not determined and conditioned by the export situation itself.

So in that sense, therefore, any surplus that is occurring to the Reserve in India is not on account of current account surplus. So to the extent it is not on account of current account surplus, but on account of capital account surplus, it really means capital is more than what is required to maintain the domestic balance. So I just wanted to put that in perspective.

So having done that, if there is an addition to reserves, it should be treated not so much as self-insurance. So at this stage of development, given the resilience of the economy, the confidence of the international community in the Indian economy, these quote, unquote “self-insurance” is not a top priority item in terms of the management of reserve.

So the addition to or reserve’s accumulation happens more in the context of the way in which the capital flows are up and the way in which the economy absorbs the capital flows. We have to take a medium-term view of the current account balance, medium-term view of the capital flows, and a medium-term view of the growth prospects, and that is how we have to look at the totality of these reserves.

That brings me to the issue of the management of the reserves. When you have the reserves, how do we manage? Now, what happens is, as the reserve level rises and I can be very frank with you, at one particular level of reserve, the major consideration is liquidity. But as acquisition to reserves keeps happening, then it is possible to diversify the portfolio, and increasingly there can be an emphasis on return at the margin. So very often, you will find that as the reserve level increases, the marginal return will be far higher than the average return.

But at some point of time, if you reach a position that aggregate foreign assets exceed foreign liabilities, then the reserves will become a part of the national wealth, and not reserves as such. In such a case, as Singapore has done, you can then create a separate corporation and do the wealth management. So we are familiar with the situation that perhaps we are comfortable on the liquidity, but we have not reached the stage, where our external assets are far higher than external liabilities, to treat it as purely a wealth management issue. We are in the intermediate stage. And therefore, our management of reserves will reflect this intermediate position and intermediate requirement.

WISNER: Excellent. Good.

Imran Riffat.

QUESTIONER: Mr. Governor, there is an internal debate going on in India about the capital account convertibility of the Indian rupee. What is the position of the

Reserve Bank of India with respect to the timing of this event? And what are the possible implications with respect to the domestic debt?

REDDY: First, I think internal debate is something which is good. One of the major reasons we have internal debate is that there are four English business dailies. I don't think there is any country which has four English business dailies (laughter) competing for news. (You've got one daily ?). Having said that, the capital account convertibility issue has been flagged recently. The intensity of debate is because of the committee that has been appointed to revisit the issue.

And just before coming here a few days ago, last week, I met the committee that has been appointed. Let me explain that the Prime Minister, when he visited the Reserve Bank of India -an incident that I am honored, the first time in the 70-year history of the Reserve Bank that the Prime Minister has visited the Reserve Bank - and he said that the RBI and Finance Minister could revisit the issue of the capital account convertibility and the state of the capital account liberalization, which we agreed. As the world has changed significantly since the East Asian crisis, Indian economy and the Indian financial sector has changed significantly, and therefore we should revisit the issue. That's the mandate.

So the mandate is simply to revisit, capture the current realities and see how we should go forward, and I have addressed this issue in the monetary policy. As far as the monetary policy link is concerned, in a way, some hard decision have to be taken in terms of monetary management, exchange rate management, interest rate management as we have greater capital account liberalisation, quote, "openness."

So it is in this background that the committee has been appointed. So in my meeting before the committee -and I want to confess with you - I confess to you that I told the committee that the Reserve Bank has no position on this issue. We are open, and we will share whatever technical papers, global experience and our assessment that are needed. The committee is being encouraged to meet as many experts as possible, and come up with a report which indicates what appear to be the basic factors that should be taken into account in the way forward.

And I have also requested the committee to make its report available in public domain. Whatever their analysis, assessment and road map is concerned, I said we will put it in public domain, being open to all the comments, discuss with the government, and then proceed.

So the frank answer is we are very open to all the good ideas, all the suggestions to the committee, and further action. There is no stated, predetermined position of the Reserve Bank on this.

QUESTIONER: Thank you.

WISNER: Young lady at the first table.

QUESTIONER: Good morning. Nisha Kumar, Time Warner. Mr. Governor, from your perspective, what should be the priorities of U.S. policy towards India to help advance its growth? And practically, how do you think those can be achieved?

REDDY: Again, that is not exactly my territory. (Laughs.) But at the outset I should say that our relations with the Federal Reserve and Federal Reserve New York are excellent. I will be meeting Mr. Tim Geithner later today. And I cannot further ask for a better relationship than what we have, in terms of the monetary and banking sectors. And from the global point of view, as I understand, compared to at any point of time with the type of visitors that I get from the United States, it is a pleasure to interact, and I think there is total understanding of both the problems and prospects. So if you ask me, I think the going is good, there is nothing wrong, and therefore, we need not try to fix thing. Let us keep doing what we are doing now. That would be my sense of it.

WISNER: Good.

Yes, sir? Right there. Second table.

QUESTIONER: Sean Fieler with Equinox Partners. To the extent that your priority is improving growth in rural India and extending more credit to rural India, isn't one of the obvious solutions accelerating the deregulation of the public sector banks that have the dominant footprint and large deposit base in rural India? And if I think of a HDFC (sp) or a ICICI (sp) running, you know, SBI (sp) as it were today, with the freedom to hire executives and promote people and have a more meritocratic and entrepreneurial culture. I think that that might go a long way to improving that particular problem. And I know there's probably political problems with anything that would allow firing of workers, but there's got to be other things at the margin that can be accelerated there. If you'd comment on that.

REDDY: I think that is an idea. But as you know, in the Indian context there are a lot of good ideas which keep floating around. (Laughter.) And some are picked up, some are not, for a variety of reasons. And you know that.

But having said that, I will say, I would most humbly submit that the performance of public sector banks, if we just take the report of trends and progress in banking, which indicate that the performance of the public sector banks in the recent years has been very impressive. And the more important thing is and let us accept that when we compare the performance, we should also take into account the overhang problems. The public sector had a overhang problem of technological advance, but when a license was given for ICICI, we made it a condition that you must adopt modern technology. Second, there is an overhang problem of personnel, and we cannot simply say that the personnel should go home; it is just not on. Third, there is the overhang of nonperforming assets. The huge overhang of nonperforming assets in many other countries were taken over by government or separate companies for distressed assets were created or it

was taken over by the fisc. In India it was not taken over by the fisc and banks have been asked to absorb the losses. So in terms of our predictive indicators of performance, given the background, the public sector banks have been able to deliver significantly both in terms of stability and in terms of penetration and the technological improvements that have happened during the last two to three years.

Fourthly, and most important, in India the issue is not public sector banks versus private sector banks now. There are old private-sector banks, there are new private-sector banks, and then public-sector banks in which there is a combination of private and public ownership.

So the way I look at it is, definitely from a NEW YORK perspective where I am sitting, the best judge of the performance of bank is the market, the stock market. And the stock market is every time giving a very good signal of what are public sector banks, in spite of increased competition.

Having said that, let me again repeat that there is a long way to go. And in the long way to go, the way I look at it is there is a real increase in collaborations and cooperation between public and private sector banks. So the balance between public and private, foreign and domestic, in operations, in ownership, in competition, in different market segments, will keep changing. And I only hope that at some date we reach a point suddenly the world will notice that we are doing well in financial sector also (Laughs) apart from macroeconomy.

WISNER: Yes, sir?

QUESTIONER: Jaime Juan, Granite Associates. You just mentioned nonperforming assets. RBI has been very proactive in recent years regarding these. With regard to the foreign investment in that sector, could you describe how you see that going forward?

REDDY: I would say that the opening up of the securitization has been a more recent phenomenon we have just introduced. But again, in many developing countries, the securitization has come after the government took over the business assets. So here we have been going a little slow in that matter, and only recently the legislation has been passed. I think there is enormous scope for securitization. I think the foreign investors will be in a position to participate both on the direct investment side and in picking up the securities as we go along. But as usual, it is incremental, it is gradual, but I see a great potential both for improving the banking system and for an opportunity for the foreign investment.

WISNER: Governor, we have put you through your paces this morning, and I thank you enormously on behalf of the Peter McCullough Series and the council, and thank all of you for coming to what I found a very spirited session.

Governor, we were all raised on the discipline that Reserved Bank, Central Bank governors say very little. You said a lot. You were uncommonly frank and

interesting, and I must say, on my behalf and I know every one here, we appreciated it.

Come back. You are a welcomed guest in the council, and we look forward to seeing you many times and particularly, sir, these terrific moments. Good luck in the work that you and the RBI are doing.

REDDY: Thank you very much (Applause.)

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