*Financial Sector Reforms**

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The economy is stabilising, but there is no room for complacency. Some part of improvement in the Current Account Deficit (CAD) has happened due to suppressing gold imports. Not all the measures to reduce fiscal deficit are of high quality. We have considerable work to do still. At the same time the country faces elections next year. A stable government post elections, while likely, cannot be taken for granted. This implies that all parties have to work together today to ensure that any government that emerges post-election has the time to come to terms with the challenges of managing the Indian economy. Otherwise, markets and rating agencies may not be willing to cut the new government any slack.

More generally, it would be overly complacent and possibly dangerous for parties to postpone necessary legislation with the idea that they will pass bills post-election. Post-election politics may become even more challenging, whoever assumes power. Similarly, any slowdown in putting large stalled projects back on track before the elections or any fiscal slippage, will only amplify the already large challenges the new government will have to face. It will benefit the nation enormously if parliament passes key bills and if the current authorities continue to take actions to improve growth and fiscal health, including raising diesel prices to market levels and eliminating other poorly targeted subsidies.

This Conclave, however, is about the medium term. Looking to the medium term, our measure of success should be the jobs that are created: Created not by giving government subsidies or protections to labour-intensive industries or sectors but by developing a facilitating, competitive, environment that will encourage efficiency and creativity.

The job agenda requires a disciplined focus on 4 issues:

1) We need to improve the quality of our infrastructure, especially the logistical support and power that industry and services need. Grand plans are on the anvil, such as the Delhi-Mumbai Industrial Corridor. We need to complete such projects on time, and within budget. The success of the New Delhi Metro suggests that timeliness and cost control are not foreign to the Indian psyche.

2) Our youth need education and training for the jobs that will be created. Some of this will be higher degrees, not just computer science but also design or civil engineering. Some of it will be appropriate vocational education that teaches them to be good plumbers and electricians rather than unemployable low-skilled engineers. In fact, teaching our citizens can be a stepping stone to teaching the world. India can be at the forefront of providing mass technology-enabled education with our professors providing appropriate human inputs to achieve the best mix of automation and customisation for learning.

3) We need better business regulation. This does not always mean less regulation but it means regulation that is appropriate to the objective and, that is enforced. Entrepreneurs tell me about boiler inspectors showing up at software outfits, asking for the location of the boiler. The lack of change may be sheer inertia, but it may be more sinister rent-seeking. All too often, we have too much regulation on the books and too little regulation in practice, with the worst of the regulated finding unscrupulous ways around the regulation while the honest are stymied.

   Even opening a business legitimately requires an enormous number of clearances and paperwork. In the same way as we have Saral form for filing income tax, could we have a Saral one page disclosure for opening a small business, with a single authority giving all necessary permissions?

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4) And finally, we need a better financial system, which will finance the needed infrastructure and the expansion of every producer ranging from the *kirana* shop owner to the industrialist. But finance is not only about credit. Equally important is for households to be able to save safely with positive real returns, insure themselves against health emergencies or old age costs, and borrow at low cost to finance consumption. They should be able to make remittances cheaply and pay at low cost. Importantly, the financial system should not require constant subsidies to bail it out.

In the rest of this talk, I want to focus on what we, at the Reserve Bank, are doing to improve the financial system. We plan to build the Reserve Bank's developmental measures over the next few quarters on five pillars. These are:

1. Clarifying and strengthening the monetary policy framework.
2. Strengthening banking structure through new entry, branch expansion, encouraging new varieties of banks, and moving foreign banks into better regulated organisational forms.
3. Broadening and deepening financial markets and increasing their liquidity and resilience so that they can help allocate and absorb the risks entailed in financing India's growth.
4. Expanding access to finance for small and medium enterprises, the unorganised sector, the poor, and remote and underserved areas of the country through technology, new business practices, and new organisational structures; that is, we need financial inclusion.
5. Improving the system's ability to deal with corporate distress and financial institution distress by strengthening real and financial restructuring as well as debt recovery.

Let me elaborate on each of these measures a little.

First, we are among the large countries with the highest consumer price inflation in the world, even though growth is weaker than we would like it to be. Much of the inflation is concentrated in food and services. Our households are turning to gold because they find financial investments unattractive. At the same time, many industrial corporations are complaining about high interest rates because they cannot pass through their higher costs into higher prices for their products.

We can spend a long time debating the sources of this inflation. But ultimately, inflation comes from demand exceeding supply, and it can be curtailed only by bringing both in balance. We need to reduce demand somewhat without having serious adverse effects on investment and supply. This is a balancing act, which requires the Reserve Bank to act firmly so that the economy is disinflating, even while allowing the weak economy more time than one would normally allow for it to reach a comfortable level of inflation. The weak state of the economy, the recent stability of the rupee, as well as the good *Kharif* and *Rabi* harvest this year, will generate disinflationary forces that will help, and we await data to see how these forces are playing out. No single data point or number will determine our next move.

I think the market understands what we are trying to do. But we do need a more carefully spelled out monetary policy framework than we currently have. Action on the framework will follow the submission of the Dr. Urjit Patel Committee report, which is expected to submit its report by end-December 2013.

Second, we have already announced measures to free bank branching. We also want to incentivise foreign banks to incorporate domestically, which the RBI has been planning since 2005. This will allow us to regulate them better and reduce the risks of contagion, stemming from foreign shores. This is a necessary measure to ensure the stability of our banking system. It is a measure which many other countries have embarked. Going forward, we have to give our public sector banks, which are a national asset, the means to improve their competitiveness. Many of them have made enormous strides in the last decade – for instance, the extent to which they have digitised their operations is extremely praiseworthy – but because competition in the banking sector is likely to increase in the next few years, they cannot rest on their laurels. In the coming months, we will discuss with stakeholders in public sector banks about what needs to be done to further improve their stability, efficiency and productivity.

Third, we need to enlist markets in the aid of financial institutions. Liquid markets will help banks offload risks they should not bear, such as interest rate or exchange risk. They will also allow banks to sell assets that they have no comparative advantage in holding, such as long-term loans to completed infrastructure projects, which are better held by infrastructure funds, pension funds, and insurance companies. Liquid markets will help promoters raise equity, which is sorely needed in the Indian economy to absorb the risks that banks otherwise end up absorbing. Rather than seeing markets as being inimical to the development of the banking sector, we have to see them as complimentary.

In the coming weeks, we will roll out more measures to improve the liquidity and depth of the G-Sec market. We will then turn to money markets and corporate debt markets. We have introduced new variants of interest rate futures and products like inflation indexed certificates, and we will continue to work to improve liquidity in derivative markets. As the exchange markets became unstable, we imposed restrictions on participation in these markets. We will remove these restrictions in a calibrated fashion.

Fourth, we have to reach everyone, however remote or small, with financial services. Financial inclusion does not just mean credit for productive purposes, it means credit for paying a doctor to heal your child or to pay lumpy school or college fees. It means a safe mode of remunerated savings, and an easy way to make payments and remittances. It means insurance and pensions. It also means financial literacy and consumer protection.

We have made great strides in inclusion, but we are still some distance from our goal. We have adopted a branch based strategy for inclusion, but it is not enough. Too many poor people in so-called 'over-branched' urban areas still do not have access to banking services. We have many experiments under way to use technology, mobile phones, new products such as mobile wallets, and new entities as business correspondents to link people up to the formal financial system. Much as with cell phones where we created a frugal Indian model, we need a frugal, trustworthy, and effective Indian model for financial inclusion. The Dr. Nachiket Mor Committee is helping us think through possible models, and I am hopeful that when we outline measures based on its recommendations, our fine banks, NBFCs, IT companies and mobile players will rise to the occasion. The key will be to encourage entities to compete to serve the customers at the bottom of the pyramid. We should tolerate their making profit but not profiteering, and we will enhance our efforts in consumer protection and consumer literacy accordingly.

And last but not the least, we have to deal better with distress: We have to ensure that the system recognises financial distress early, takes steps to resolve it, and ensures fair recovery for lenders and investors. We could wish for a more effective judicial process or a better bankruptcy system, but while we await that, we have to improve the functioning of what we have. Next week, we propose to put out a paper for discussion that will focus on putting real assets back to work in their best use. The key elements to deal with distressed borrowers will include:

(i) Early formation of a lender committee with timelines for reaching agreement on a plan for resolution.

(ii) Stronger incentives for lenders to agree collectively and quickly to a plan – this will involve better regulatory treatment of stressed assets if a resolution plan is formulated and agreed to, accelerated provisioning if no agreement can be reached.

(iii) A mandated independent evaluation of large value restructurings, with a focus on plan viability and a fair sharing of losses (and future possible upside) between promoters and creditors.

(iv) More expensive future borrowing for wilful defaulters or uncooperative defaulters who do not work with lenders to achieve an efficient and equitable resolution of distressed assets.

(v) More liberal regulatory treatment of asset sales and more encouragement for new entities to purchase or refinance assets.

The lesson of every period of financial stress across economies has been that early recognition and resolution of problems gives the economy its best chance of robust recovery. Through the measures that will be outlined next week, the RBI intends to help promoters and banks deal effectively with the financial stress that has built up.

Let me conclude. I will depart from the usual conservatism of a central banker to predict that the best of India is yet to come. We will be a healthier, better educated, and richer nation, not just in absolute terms, but even relative to other countries. This is not a jingoistic statement based on some intrinsic Indian superiority but a sober recognition that we are still much poorer than other countries, and catching up is always easier than drawing away from the pack. But we can achieve these outcomes only if we go about addressing the challenges we face methodically, with discipline and a sense of national purpose. In the coming years, I hope that is what we will do.