Indian Economic Scenario: Yesterday, Today and Tomorrow *

Vepa Kamesam

I am honored to address this gathering which has been facilitating constructive interactions and garnering public debate on various issues confronting India. The theme chosen for this gathering 'Indian Economic Scenario – Yesterday, Today and Tomorrow' is one of the most important issues requiring wide public debate as the Indian Financial system is passing through a phase of transformation and consolidation. It is time to build strategies for the challenges that lie ahead in achieving the goal of a vibrant and internationally competitive economy. The topics *viz.*, agriculture, industry, banking and IT has been excellently chosen as they are *sine-qua-non* for a healthy economy and any of these could become a source of vulnerability to the economic set up of any country. Let me dwell upon the four topics individually.

Banking

A strong and efficient financial system is critical to the attainment of the objectives of creating a market-driven, productive and competitive economy and to support higher investment levels and accentuate growth. Banking by far is the most dominant segment of the financial system and plays a pivotal role in the development of a sound economy. A healthy banking system, besides providing necessary architecture for facilitating economic growth, also serves as a strong repository of liquidity. The Indian banking system has traversed a long journey to come to this phase where the health and quality of the banking system and the contribution made by it in the economic development can be comparable to the International standards. If we look behind it is really heartening to note that the Indian banking system has progressed in every aspect from being a financial intermediary to the vehicle of economic growth. Before the financial sector reforms, which was initiated in 1991, Indian banking operated under structural rigidity and external constraints besides working under a protected environment. The first phase of financial sector reforms, triggered by the recommendations made by the Committee on the Financial System under the Chairmanship of Shri M. Narasimham in August 1991, consisted of easing of various structural rigidities so as to foster competition in the banking sector. The first phase aimed at providing necessary platform to the banking sector to operate on the basis of operational flexibility and functional autonomy, thereby enhancing efficiency, productivity and profitability. The reforms brought out structural changes in the financial sector and succeeded in easing external constraints in their working, introducing transparency in reporting procedures, restructuring and recapitalising banks and increasing the competitive element of the market through the entry of new banks. The policy initiatives taken since the onset of reforms has brought about remarkable improvement in respect of various parameters determining banks' performance ranging from profitability, credit management, corporate governance, human resource development, *etc.* The major agenda, triggered by the banking sector reforms initiated in 1992, has been deregulation of the financial sector with greater autonomy in operations, consolidation of banking system and convergence to universal banking, restructuring of weak public sector banks, adoption of scientific tools for management of risks *etc.* Interest rate deregulation has given necessary latitude to banks to price their products based on their commercial judgement, which includes factors like liquidity, yield, risk exposures, capital requirement, interest rate outlook, *etc.* With a view to strengthening the financial position of banks, a capital to risk weighted asset system was introduced for banks in India from the year 1992-93 more or less in conformity with international standards. An objective criterion of income recognition, asset classification and provisioning norms based on uniform period of delinquency and aging profile was introduced since 1992 in phases. Apart from the policy initiatives mentioned above, several decentralising measures have been taken as a result of the first phase of the reforms, which are include permission to nationalised banks to reduce the Government's equity from 100 per cent to not less than 51 per cent, greater operational freedom to banks to open specialised branches such as industrial, international business, SSI, *etc.*, off-site ATMs and administrative offices and announcement in 1997, a package of autonomy to public sector banks fulfilling certain criteria. The first phase of reforms had the desired effect which was seen in the improvement in the efficiency, productivity and profitability of banks, major changes took place in the macroeconomic environment, policy and institutional developments. These called for a critical evaluation of the policy initiatives already undertaken. Accordingly, the Government of India set up in 1997 a Committee on Banking Sector Reforms under the Chairmanship of Shri M. Narasimham to review the record of implementation of financial system reforms recommended by the earlier Committee and to look ahead and chart the reforms necessary in future to make India's banking system stronger and better equipped to meet the global competition. Whereas the first phase of financial sector reforms consisted of easing of various structural rigidities so as to foster competition in the banking sector, the second phase of reforms, which is underway, relates to introduction of sophisticated financial instruments and facilitating consolidation and rationalisation of banking system. The policy initiatives taken as a result of the second phase of banking sector reforms included strengthening the capital base of banks, aligning prudential norms more closer to international standards, removal of rigidities in the legal system and providing more comfort level to banks in recovery of dues, reduction of Government Shareholding in Government owned banks, encouraging banks to adopt latest tools in mitigation of various types of risks associated with their operations, enhancing transparency in banks' balance sheet, entry of new private sector banks, *etc.*

As a result of the focussed agenda and concerted implementation of the recommendations made by the Committee on Banking Sector Reforms, the face of Indian Banking System has undergone a sea change as compared to a decade ago. The banking system now is subjected to highest level of prudential regulations, accounting standards and disclosures, which are almost comparable to the international best practices. Entry of more foreign banks and emergence of new private banks has made the banking environment more competitive. The reform process has ensured that banking expertise/ technology competence exist in the market to provide healthy competition and wider choice to the clients. Realising the potential of the Indian market, foreign investors have shown greater interests in Indian banks. A policy announcement has been made to allow foreign banks to set up banking subsidiaries in India. Various measures like tightening of prudential norms for asset classification, income recognition, provisioning as well as prudential norms on capital adequacy has been carefully sequenced by RBI to ensure that in the process of achieving the goal of reform, there are no systemic disruptions in the sector. As a result of the careful sequencing of the reform process, it has been easier for the banks to adopt the new norms, which in turn has improved their financial strength and has made them stronger. The financial indicators suggest that banking system has responded well to the reform process. The average CRAR of all banks have increased from 9.23 per cent as on March 31, 1994 to 12.76 per cent as on March 31, 2003. This shows that the banks have been able to build up the capital cushion over the years to support the anticipated growth in their risk weighted assets. Further, on the NPA front, though the level of gross NPAs in absolute terms has been increasing over a period, the gross NPAs, as a proportion of gross advances, has been declining steadily and distinctly over the years since RBI introduced the objective criteria for identification of NPAs. The percentage of gross NPAs to gross advances for all banks, which was 14.4 per cent in 1997-98, decreased to 9.50 per cent as on March 2003. There has been commendable improvement in the business indicators of banks *i.e.* in terms of profitability, Return on Assets, Business per Employee, *etc.*

As a part of the new supervisory strategy, off-site monitoring system for surveillance over banks (OSMOS) was put in place in RBI in March 1996 as an additional tool for supervision over banks to supplement the on-site inspections. The system requires periodical reporting on supervisory concerns such as capital adequacy, asset quality, operating results and large credit exposures in respect of domestic operations by all banks in India. Data on connected and related lending and profile of ownership, control and management are also obtained in respect of Indian banks.

Bank profiles containing bank-wide database on all important aspects of bank functioning including global operations are being updated annually on an on-going basis. The database provides information on managerial and staff productivity areas besides furnishing important ratios on certain financial growth and supervisory aspects of the bank's functioning.

Analysis of financial and managerial aspects under the reporting system is done on quarterly basis in a computerised environment in respect of banks and reviews are placed before BFS for its perusal and further directions. The second tranche of returns covering liquidity and interest rate risk exposures were introduced in June 1999.

Trend analysis reports based on certain important macro level growth/ performance indicators are placed before BFS at periodical intervals. Some of the important reports generated by the Department include half-yearly review of the performance of banks, half-yearly key banking statistics, analysis of impaired credits, analysis of large credits, analysis of call money borrowings, analysis of non SLR investments, *etc.*

The analysis also provides details of peer group performance under various parameters of growth and operations for the banks of a comparative business size to motivate them to do self assessment and strive for excellence.

The Indian banks conducting overseas operations, report the assets and liabilities, problem credits, maturity mismatches, large exposures, currency position on quarterly basis and country exposure, operating results *etc.* on an annual basis. The reporting system has been revised, in consultation with the banks and have been put in place in June 2000. The revised off-site returns focus on information relating to quality and performance of overseas investment and credit portfolio, implementation of risk management processes, earning trends, and viability of the branches.

A risk based supervisory regime as a means of more efficient allocation of supervisory resources has been introduced on the pilot basis. The risk based supervision project, which was guided by international consultants with the assistance of Department for International Development (UK), would lead to prioritisation of selection and determining of frequency and length of supervisory cycle, targeted appraisals, and allocation of supervisory resources in accordance with the risk perception of the supervised institutions. The Risk Based Approach will also facilitate the implementation of the supervisory review pillar of the New Basel Capital Accord, which requires that national supervisors set capital ratios for banks based on their risk profile. To ensure smooth transition to RBS, banks were involved in a consulted process to identify the support required by them. The risk profile templates have been tried by banks for undertaking assessment risks. The pilot run of risk based supervision of select banks has been undertaken during the current inspection cycle.

To guard against regulatory forbearance and to ensure that regulatory intervention is consistent across institutions and is in keeping with the extent of the problem, a framework for Prompt Corrective Action (PCA) has been developed. The PCA framework, which will link regulatory action to quantitative measures of performance, compliance and solvency such as CRAR, NPA levels and profitability, has been introduced initially for a period of one year after which it will be reviewed.

Having talked about the path traversed by the Indian banking system, let us now look into the future of the Indian banking system, the challenges that lie ahead and what roadmap would be more appropriate. Charting out an appropriate Road Map for future reform process in the banking sector is of paramount importance to ensure financial stability. The road map is to be drawn keeping in view the increasing complexity in the market place on account of liberalisation, globalisation and technological advancement which has given rise to heightened and new forms of risks. This is evident from the emergence of complex instruments, financial conglomerate or similar structures, electronic and Internet banking, trend towards consolidation in financial sector evidenced by mergers and acquisitions and large capital flows. The future reform process of Indian Banking involves a long term strategy for the banking system which would broadly cover areas like structural aspects, business strategies, prudential standards, control systems, integration of markets, technology issues, credit delivery mechanism, information sharing and the role of regulator/ supervisor.

The broad areas, which would receive the focus of the future reform agenda, would be as under :

- The structural aspects of the financial sector in India would address the issue of consolidation of the banking sector into international banks, national banks and local banks. The consolidation of the banking system may not only cover the public sector banks but would also encompass the old private sector banks on a regional or zonal basis.
- With increasing competition and globalisation the need for specialised one window service concept will grow. Banks would, therefore be required to draw business strategies keeping in view their risk bearing capacity, need for capital, maintaining profitability in a competitive environment, developing a proper business mix, management of NPAs, rationalisation of network of offices in India as well as abroad and deployment of staff in the post VRS scenario. The banks would also have to explore new markets and consolidation of overseas operations –expansion / relocation / exit policies on overseas presence with reference to the client profile, business opportunities, *etc.*

- One of the prime thrust areas for the future would be completion of branch computerisation and networking of banks enabling customers to perform transactions anywhere. On account of these developments, appropriate legal and security systems would have to be put in place.

Let me now come to the second theme of today's discussion. You will agree that banks are basically financial intermediaries. Industry, by far is the largest user of bank finance. Hence, to what extent banking system has been successful in acting as financial intermediary depends upon the extent of bank credit to the industrial sector.

Industrial Credit

The Reserve Bank has come a long way from an era of tight regulation of banks to the present day deregulated and liberalised environment. Banks were earlier required to extend working capital to various categories of borrowers based on specific parameters laid down by the Reserve Bank for individual sectors as suggested by Tandon and Chore Committees. Further, the Credit Authorisation Scheme (CAS) which was famous in the yester years was applied when ever large quantum of working capital finance had to be given out to borrowers and only after a detailed scrutiny on several accounts were banks permitted to extend a particular level of working capital to the industry. In due course CAS gave way to the Credit Monitoring Arrangement Scheme where the banks were required to report the extent of credit given to large borrowal accounts, instead of forwarding the actual loan proposals.

However, with effect from April 1997, such tight regulation of credit has been done away with. The concept of maximum permissible bank finance introduced in November 1975 on implementation of the recommendations of the Tandon Working Group to frame guidelines for follow-up of bank credit was liberalised over the years. Consistent with the policy of liberalisation greater operational freedom was provided to banks and RBI withdrew the prescription of maximum permissible bank finance. Banks are now free to determine the working capital requirements according to their risk perception of the borrower and his credit needs; the only requirement which continues to this day is that the bank should lay down with the approval of their Boards transparent policy and guidelines for credit dispensation for each broad category of economic activity. Banks are also governed by exposure norms relating to single borrowers/group of borrowers and other prudential norms which have been laid down by the Reserve Bank in tandem with global best practices. Similarly, the mandatory norms relating to consortium/multiple/syndicate lending were also withdrawn so much so the banks could be free to adopt the route and quantum of credit in a mutually acceptable manner. Together with this, the guidelines relating to issuance of and investment in Commercial Paper have been actively liberalised. In fact, it is observed now that more and more of the top corporates do not approach banks for working capital finance, but, instead resort to private placement of debt or floating of commercial paper to augment their working capital requirements. Thus, it is observed that banks have moved from a stage of complete dependence on RBI instructions to a scenario where individual and portfolio level decisions on dispensation of credit are made by the banks based on their commercial judgement and prudential guidelines.

The Reserve Bank introduced Loan System of delivery of bank credit with prescription of minimum loan component in order to instill an element of discipline among the borrowers in relation to the cash management. From this scenario of mandating inclusion of loan component in the working capital limits, the Reserve Bank has allowed the banks offer flexibility to their borrowers in deciding the relative proportions of cash credit and demand loan components depending on the specific and individual needs of the units. The Bank has also made efforts to direct credit to sectors/areas where the flow of finance has been considered to be inadequate or where further trust has been perceived to be required. Thus, financing of infrastructure has received the attention of the Reserve Bank over the past few years. There has been a process of continuous liberalisation of the norms with a view to ensuring more efficient flow of finance to this sector. Right from enlargement of the scope of infrastructure, to the grant of additional individual/group exposure limits. Further, financing of promoters' equity, which is not generally permitted for banks financing has also been permitted subject to certain conditions for the infrastructure projects.

Guidelines have also been issued to banks for financing Film industry since the latter were of the view that in the absence of guidelines from RBI, the flow of credit to Film industry was sorely lacking. The Reserve Bank, therefore, issued the guidelines to the banks to finance film production, which is considered most important part of the film industry.

In April 2003, the guidelines restricting one institution providing bank finance to a borrower on the strength of the guarantee of another bank or financial institution has been relaxed as it was perceived that the lending institution should conduct the appraisal of the loan and take credit risk rather than depending upon the assessment of another institution. This relaxation has been permitted subject to 10 per cent fund-based participation of the guaranteeing institution and few other conditions.

In view of the economic situation prevalent over the last few years, the sectors which have been especially hard hit due to the downturn in the economic conditions, we have permitted restructuring of banks loans subject to certain conditions. The guiding factor behind instructions issued was to address the temporary liquidity problems faced by the particular sector. The packages envisaged by us were mainly for restructuring/ rephasing of the outstanding loans. Banks were also instructed to provide fresh need-based working capital as part of the restructuring package. Banks were permitted to extend such rehabilitation packages to those units considered as viable by them. The above indicates that RBI has been encouraging banks to extend credit to the industrial sector. The measures taken by RBI has resulted in increased bank credit to the Industrial sector. Having said about role of banking in industry, let us now dwell upon one of the most important sector of the economy which serves as the backbone to the Indian economy.

Agriculture

Agriculture contributes 22.1 per cent of the country's gross domestic product and provides employment to nearly 65 per cent of rural labour. The growth of agriculture and agricultural productivity are central to India's economic development and poverty alleviation as nearly two thirds of our people are dependent on agriculture for sustenance and livelihood. There is a vital linkage between growth of productivity in the agriculture sector and the growth of the economy as a whole. The linkage of agriculture with the rest of the economy is vital for food security, stable prices, control of inflation, financial stability and growth of gainful employment not only in agriculture, but also in agriculture-related industries and the services sector. By improving production and productivity in agriculture, we will succeed in unleashing growth impulses in the Indian economy.

Development of agriculture would depend to a great extent on improvement in infrastructure and credit delivery. The National Agriculture Policy adopted in July 2000 envisages annual growth in agriculture of over 4 per cent per annum and highlights adequate and timely supply of institutional credit to farmers. The 10th Five Year Plan has therefore, estimated that the credit requirements for achievement of 4 per cent and growth rate would be of the order of Rs.7 lakh crore over the plan period.

The ground level credit disbursed to agriculture by all agencies (commercial banks, co-operative banks and RRBs) was estimated at Rs.70,800 crore during 2002-03. The shares of commercial banks, cooperative banks and RRBs were 58 per cent, 34 per cent and 8 per cent respectively.

Agriculture credit constitutes an important part of priority sector lending by commercial banks. A target of 18 per cent of net bank credit has been stipulated for domestic scheduled commercial banks for lending to agriculture. To ensure that the focus of the banks on credit flow to the direct category of agricultural advances does not get diluted; it has been stipulated that the lendings under the indirect category should not exceed one-fourth of the agricultural sub-target of 18 per cent, *i.e.* 4.5 per cent of net bank credit for the purpose for computing the achievement of banks under the 18 per cent target. However, all agricultural advances under the categories ‘direct’ and ‘indirect’ are reckoned in computing performance under the overall priority sector target of 40 per cent of the net bank credit.

Data relating to outstanding agricultural advances of public sector and private sector banks show that the amount of outstanding advances to agriculture in absolute terms has increased substantially over the years, although as percentage to net bank credit, it has been below the stipulated level of 18 percent. In fact, outstanding advances to agriculture by public sector banks had grown during the period 1991-2002 from Rs. 15,857 crore to Rs. 63,083 crore at an annual compound rate of 13.4 per cent. In the case of Indian private sector banks, total agricultural advances went up during the period from Rs.434 crore to Rs.8,022 crore at annual compound rate of 30.4 per cent. The net bank credit of public sector and private sector banks had grown at annual compound rate of 12.8 and 26.4 per cent respectively during the same period.

The problems relating to rural infrastructure have been addressed to a certain extent through the Rural Infrastructure Development Fund (RIDF). Since the year 1995-96, public sector and private sector banks having shortfall in lending to priority sector / agriculture are allocated amounts for contribution to the Rural Infrastructure Development Fund (RIDF) established with NABARD. So far, nine tranches of RIDF have been established with aggregate corpus of Rs. 34,000 crore. The RIDF is utilised for assisting State Governments in completion of rural infrastructure projects and this is expected to improve the credit absorption capacity in the areas concerned, apart from providing the much-needed infrastructural support for agricultural production and development.

In the case of RIDF-I to VI, the rate of interest on deposits placed by banks in the Fund was uniform for all banks irrespective of the extent of their shortfall. Effective RIDF-VII, it was decided to link the rate of interest on RIDF deposits to the banks' performance in lending to agriculture. Accordingly, banks receive interest from NABARD on contribution to RIDF at rates of interest inversely related to the shortfall in agricultural lending. In the case of RIDF-IX, these rates of interest ranged between Bank Rate + 1.5 percentage point to Bank Rate - 1.5 percentage point.

The Reserve Bank has taken several measures to improve credit flow to the agriculture sector. Under advice of RBI, public sector banks have been formulating Special Agricultural Credit Plans (SACP) since 1994-95 by fixing self-set targets for disbursement during a year (April-March). With the introduction of SACP, the flow of credit to the agricultural sector by public sector banks has increased substantially from Rs. 8,255 crore in 1994-95 to Rs. 29,332.39 crore during 2001-02.

Another innovative measure has been introduction of the Kisan Credit Cards, which has been well received both by banks and the borrowers. Cumulatively, 95.16 lakh KCCs have been issued by public sector banks since inception of the scheme up to December 2002. As announced by the Union Finance Minister in his Budget Speech for the year 2001-02, all eligible agricultural farmers are required to be covered under the KCC Scheme by March 2004. Kisan Credit Card holders are also eligible for a personal accident insurance package.

Other steps taken include expansion of the scope of lending to agriculture by commercial banks to include lending through NBFCs, loans to agri-clinics and agri-business centres, loans for purchase of land by small and marginal farmers *etc.*

The thrust for the development of the agriculture sector during the Tenth Five Year Plan (2002-2007) as indicated in the Approach Paper to the Plan, is on augmenting agricultural production by bringing about improvements in productivity, value addition and exports. As envisaged in the National Agriculture Policy, progressive institutionalisation of rural and farm credit will be continued for providing timely and adequate credit to farmers. The rural credit institutions will have to gear up to meet the increasing credit requirement of the agriculture sector. The challenge before the banks would be to improve flow of credit to agriculture while ensuring viability of their operations.

The role of the co-operative banks assumes significance in the context of provision of agricultural credit. The cooperative credit structure in India is almost a century old and enjoys a unique position in the rural credit delivery system with its vast network covering the remotest parts of the country. The co-operative credit institutions are basically farmers' organisations set up primarily to meet the latter's credit related requirements and they also provide other credit linked services, like input supply, storage and marketing of produce, *e t c* ., thereby influencing the all-round development of agriculture and the betterment of the life of villagers. The importance of co-operatives in dispensation of credit and allied services in the rural areas has therefore been emphasised, time and again, by several Committees right from the All India Rural Credit Survey Committee in the early '50s and the policies of RBI, NABARD, Governments, both at the Centre and States, have been one of fostering the growth of the cooperative movement. The co-operatives have continued to play a crucial role in the rural credit scenario even after the entry of commercial banks and regional rural banks with their vast rural branch network.

One of the major issue being faced by the co-operative credit system is the high rate of interest at the beneficiary level. Whereas the NABARD lends the state co-operative banks at 6 per cent by the time credit reaches at the member level the rate of interest increases to 14 to 15 per cent. The efficiency in the system, therefore, needs to be further enhanced to reduce the rate of interest. It is with this view that the NABARD Act has been amended to enable it to refinance the District Central Co-operative Banks directly with the caveat that State support would be made available to the institutions for increasing their efficiency.

For historical reasons, two parallel wings of co-operative credit institutions have come into existence and developed; one for providing short-term and medium-term credit to the farmers and the other for dispensing long-term credit at first for debt redemption and subsequently for investment in agriculture. The short-term credit structure obtaining in most parts of the country has been a federal one with a three tier system *viz.*, the State Co-op. Banks (SCBs) at the apex level in each state, the Central Co-op. Banks (SCBs) at the district level and Primary Agricultural Credit Societies (PACS) at the village level. In smaller states and Union Territories having two tier structure, the credit requirements of the PACS are being directly met by the SCBs. As on March 31, 2003, there were 370 DCCBs and 30 SCBs operating in the country. The number of PACS stood at around 99,000 as at March 2001.

The organisational structure of long-term co-operative credit is not of a uniform pattern all over the country. While in some states, it has a federal set up with the State Agricultural and Rural Development Bank (SCARDB) at the state level and the affiliated primary ARDBs at the district or taluka level, in some states, the structure is of a unitary type with the State level ARDBs operating through their own branches. In some states, there is a mixed structure incorporating both unitary and federal system. In Andhra Pradesh, an integrated structure of cooperatives providing all types of agricultural credit (both short-term and long-term) under ‘Single Window’ credit system is prevalent. In smaller states, there is no long-term structure at all and the long-term credit needs are met by the State Cooperative Bank in the State concerned together with other rural financial institutions. Various Committees have suggested either merger of the long-term structure with the short-term structure or conversion of the ARDBs into full-fledged banks. However, several issues need to be addressed before such a move can actually materialise.

The health of many SCBs and DCCBs is a matter of concern, as at December 2002, as many as 137 out of 370 DCCBs and 8 out of 30 SCBs were not fulfilling the provisions of Section 11(1) of the B.R. Act, 1949 (AACS) relating to minimum capital requirement. Thus, with many co-operative banks experiencing grave problems threatening their very survival, the issue of good governance in the cooperative banks has assumed criticality. Capoor Committee has gone into this issue of rehabilitation of co-operative credit system and suggested various measures including recapitalistion, removal of dual control, cooperative governance issue and reduction in the role of state. These recommendations need to be addressed in order to strengthen the system.

As regards credit delivery to the weaker sections of the society, one of the issues that would need focused attention is the provision of micro credit through the banking system. The Self Help Group (SHG)-bank linkage programme pioneered by NABARD which leverages the large network of bank branches in the country to provide micro credit to the rural poor, has become an important mode of financing the weaker sections. The number of SHGs linked to banks aggregated 7,17,360 as on March 31, 2003. This translates into an estimated 11.6 million very poor families brought within the fold of formal banking services. About 90 per cent of the groups linked with banks are exclusive women groups. Cumulative disbursement of bank loans to these SHGs stood at Rs.2,048.7 crore as on March 31, 2003 with an average loan of Rs.28,560 per SHG. With substantial increase in the number of SHGs linked with banks, coordinated efforts are necessary among all agencies to further improve the flow of credit.

The reform of the interest rate regime has constituted an integral part of the financial sector reforms initiated in our country in 1991. In consonance with this reform process, the interest rates applicable to loans given by banks to micro credit organisations or by the micro credit organisations to Self-Help Groups/ member beneficiaries has been totally left to their discretion. The banks have also been given complete freedom to formulate their own model[s] or choose any conduit/intermediary for extending micro credit. Micro Credit extended by banks to individual borrowers directly or through any intermediary is reckoned as part of their priority sector lending.

The Reserve Bank has asked banks to include micro credit in all their credit plans right from the branch to the state level. While no target has been prescribed for micro credit, they have been asked to accord utmost priority to the micro credit sector in preparation of these plans. Our guidelines also make it clear that micro credit should form an integral part of the bank's corporate credit plan and should be reviewed at the highest level on a quarterly basis.

Savings mobilisation being a major issue in micro finance provision, we have introduced certain major relaxations regarding requirement of registration, maintenance of percentage of assets and reserve fund for non-profit non-banking finance companies (NBFC)- MFIs. The MFIs registered as not-for-profit NBFCs have been exempted from registration and prudential requirements. As for deposit-accepting profit-MFIs, the continued insistence on ratings is primarily to ensure depositor protection, which, especially when it involves savings of people, is an overriding concern.

We have been taking reviews of how these guidelines have impacted provision of micro credit in the country. While the progress has been uneven across States, it is satisfying to note that some significant strides have been made in upscaling the purveying of micro credit across the country. A high level meeting on micro finance was held in RBI in October 2002 to review the progress made, pursuant to which four Groups were set up to look into issues relating to: (i) Structure and Sustainability; (ii) Funding; (iii) Regulations; and (iv) Capacity Building of micro finance Institutions. The recommendations of the groups were discussed in another meeting held recently in August, 2003 which was attended by senior executives of select public and private sector banks, RRBs, DCCBs, micro finance institutions, SIDBI and NABARD. As it was observed that greater public debate was required before a view could be taken, particularly on regulatory issues, the reports of the groups have been circulated among all banks to elicit their responses within a month. After receiving the feed back from the banks, the Reserve Bank would segment the recommendations in three groups (I) those which are implementable readily by banks; (II) those which are difficult to implement and need further study and (III) grey areas which need further examination, including legal aspects.

Both in matters relating to agricultural credit as well as issues involving cooperative banks, the role played by NABARD has been important. NABARD was established in terms of the NABARD Act, 1981 for providing and regulating credit and other facilities for the promotion and development of agriculture, small scale industries, cottage and village industries, handicrafts and other rural crafts and other allied economic activities in rural areas with a view to promoting integrated rural development and securing prosperity of rural areas and for matters connected therewith or incidental thereto.

It serves as an apex refinancing agency for the institutions providing investment and production credit for promoting various developmental activities in the rural areas and exercises supervisory functions over cooperative banks and RRBs through both on-site inspection and off-site supervision. Other functions of NABARD include taking measures for institution building for improving absorptive capacity of the rural credit delivery system, including monitoring, formulation of rehabilitation schemes, restructuring of credit institutions, training of personnel *etc*. NABARD administers the Rural Infrastructure Development Fund (RIDF) and also monitors/ facilitates linkage of banks to Self Help Groups (SHGs). NABARD also coordinates the rural financing activities of all institutions engaged in developmental work at the field level and maintains liaison with Government of India, State Governments, RBI and other national level institutions concerned with policy formulation and undertakes monitoring and evaluation of projects refinanced by it.

The above suggests that rural credit and in particular, agriculture has been receiving paramount importance in the economic development of the country with setting up of various institutions and the Reserve Bank has been constantly encouraging banks to extend finance to agriculture. Now, I would like to come to the issue which is most relevant in today's scenario of competition and efficiency. Now, Information technology is the backbone for an efficient financial system.

Technology and Banking

One of the most important challenges facing India now is the need for matching the urban development with rural development. The role played by rural credit in the process of development has been significant. However, given the need for large scale rural sector development to address issues of rural unemployment and balanced growth, rural credit delivery has assumed critical importance. It is also equally important to ensure that rural savings are channelised through organised financial sector, in particular the banks. It is in this context the role that Information Technology can play needs to be viewed. Just as technology is important for effecting a quantum improvement in farming techniques and in increased agricultural production, Information Technology or IT in Banking is vital for sharp progress in financial intermediation and efficient payment system.

One must, however, recognise at the outset that mere usage of computers would not by itself herald IT revolution in the rural sector. There are many other tools of IT which need to be introduced to act as catalysts in the process of transformation. With the geographical spread of banking having penetrated to most parts of the country, it is vital that Automated Teller Machines (ATMs) are widely used. ATMs would provide the rural masses with the conveniences associated with retail payment systems. At present, ATMs are city-oriented. ATMs with the rural customer as focal points may have to be introduced. ATMs could provide cash drawals as also deposit facilities to the rural common man.

Some sceptics would argue that the introduction of ATMs will not be necessary at this point of time, nay even in the medium term of say the next 3-5 years. There is, on the contrary, evidence of rise in dependence on NRI inflows by rural families. These would be one of the target groups besides the rich farming-trading families which would benefit from deployment of IT in rural areas.

To illustrate this point further, multi-purpose cards could be a facility that IT could usher in for rural population. Of specific importance is the potential that SMART cards have in this area. SMART cards – which are basically cards using computer circuits in them thereby making them 'intelligent' – would serve as multipurpose cards. SMART cards are essentially a technologically improved version of credit and debit cards and could be used also as ATM cards. They could be used for credit facilities at different locations by the holders. SMART cards could be used for personal identification and for monitoring credit usage by small farmers very importantly from the point of view of a rural entity, they could be used for availing of facilities such as subsidised seeds, fertilisers, in aiding in marketing the produce, in availing of medical facilities for both human beings as well as livestock and also in various requirements of cooperative functions that are characteristic of rural areas. The data from all the SMART card usage points could well form the repository of information for national and economic indicators, which would be more scientific, latest and provide information for quick strategy formulation by the Government.

As affluence spreads in rural areas, there could be several schemes to tap savings. For instance, Gold deposit or Gold bond scheme for the rural folk could be actively promoted. The proliferation of IT essentially triggered by the awareness brought about by the advent of television, could ensure participation of rural masses as investors in other instruments such as mutual funds schemes, equities, preference shares, *etc.*

All these would, however, require certain minimum infrastructural requirements in the rural areas. The most essential prerequisite is the availability of electric power which is an area of concern at present. The entry of solar based power – possibly for small computers and for utilities such as SMART card reader outlets, however, could provide some relief in this regard. Coverage of telecommunications is yet another area of concern, but recent experience shows that there is room for optimism in the availability of uninterrupted means of communication between and across villages and cities. The approach towards IT infrastructure in the rural areas may have to be different from the one being adopted for cities. Conglomeration of facilities such as computers, SMART card facilities *etc.*, at kiosks – possibly at telephone kiosks – could be thought of as feasible options with the participation of the educated unemployed rural youth in the setting up of such facilities.

Having dwelled upon the usage of IT in banking for the rural masses, it would also be appropriate if I outline the measures which have been taken by the Reserve Bank for the customers of banks in the urban centres too. All of you must have witnessed the significant change which has been sweeping over banking functions today. Large scale usage of IT by banks has resulted in computerisation of many branches and their inter-connectivity by means of safe and reliable networks. While the new private sector banks have all commenced as entities with fully computerised operations, the older banks too have embraced upon I T in a large way. Today, all the public sector banks are on the threshold of achieving the status of 100 per cent computerisation of their business. In fact the largest bank in the country has also networked and interconnected more than 3000 of its branches. This has meant three major benefits to the customer. First, the customer is now treated as a customer of the bank as a whole, which means that he is now capable of enjoying facilities such as 'anywhere banking' as also 'anytime banking'. Second, costs have come down. With hair thin margins being the order of the day, banks have to look for ways and means to reduce their operating costs and IT has come as a saviour in this area. Third and most important is the impact on improved customer service and overall efficiency of the bank as a whole.

All the above have positioned customers of banks as the most important source of attention by banks, thereby conforming to Mahatma Gandhi's oft-told adage of the customer being the King.

The Reserve Bank too, has provided for many tools as part of improving systemic efficiency of the Banking sector. The first major feat has been the setting up an exclusive, safe and secure communication network for the use of the banking sector. Named the INFINET (for the INdian FInancial NETwork), this network has been in operation for more than 3 years now. And Hyderabad can boast of hosting this network which is set up, managed and operated by the Institute for Development and Research in Banking Technology (IDRBT), situated at Masab Tank.

Recognising that the best impact of technology would be felt only if it ultimately improves the efficiency of funds settlement, the Reserve Bank has also provided for many new products – all of which are aimed at reforms in the existing payment and settlement systems, and providing for risk reduction, which is a major concern for central banks world wide. Commencing from the introduction of MICR based cheque clearing in the late eighties (with four metropolitan centres being part of the chain), today, there are 27 cities where cheque clearing is performed using mechanised technology of reader sorters which process cheques at more than 2000 per minute. On similar lines, the Currency Verification and Processing Systems have been made operational at various offices of the Reserve Bank which has resulted in the implementation of the 'Clean Note Policy', as far as currency notes are concerned.

The benefits of technology in the banking sector have been extended to cover transactions undertaken in respect of Government securities transactions; the Negotiated Dealing System (NDS) has provided for an electronic platform for trading in Government securities which has stabilised well in its two years of operation. Further, the proliferation of IT has also set the stage for improving and managing risks in payment systems, in the form of the following:

- Electronic Trading Systems
- Delivery versus Payment (DVP)/ Payment versus Payment (PVP)

- Real Time Gross Settlement (RTGS)
- Secured Netting Systems
- The growth of the Central Counterparty (CCP) as in the case of the Clearing Corporation of India Ltd (CCIL) and movement to Continuous Linked Settlement.

Much as we envision, the outlook for improved financial services is bright, given the high drive of IT in banking. If India is brought into the mainstream of real time payments system, the allocative efficiency of Indian Banking would be of top class by any standard.

*** Inaugural address by Shri Vepa Kamesam, Deputy Governor, Reserve Bank of India at a seminar on "Indian Economic Scenario: Yesterday, Today and Tommorrow at the "Banking-Agriculture-Industry-IT – New Hopes-New Challenges" organised by Telugu Vaibhavam at Hyderabad on September 16, 2003.**