*Address at Grand Finale of the Platinum Jubilee Celebrations of the RBI by Hon'ble Prime Minister**

"It is indeed a great pleasure to be here in Mumbai for the Platinum Jubilee celebrations of the Reserve Bank of India. For me, this is also a very special moment of nostalgia. I spent some very memorable years in this institution as its Governor. My wife and I cherish the memories of many new enduring friendships that we made during those memorable days. I also recall with deep appreciation the role played by the Reserve Bank in helping the Government of India in the implementation of the agenda for economic reforms when I was the Finance Minister of India at a very difficult time in our country's economic history. To return as Prime Minister for the Platinum Jubilee of this great institution is indeed an emotionally moving experience for me.

When I took over as Finance Minister in 1991, I was convinced that the economic liberalisation and reforms could only succeed if complemented by broad based reform in the banking and financial sectors. I turned to my old friend and former RBI Governor Shri M Narasimham to Chair a Committee to make recommendations on this very important issue. The Report of the Narasimham Committee outlined a comprehensive agenda of reform which served as a blue print of what we needed to do in subsequent years.

It would have been difficult to implement those reforms had they not received enthusiastic support, as they did, from the Governor of the day, Shri S. Venkitaramanan and Dr. Rangarajan. Subsequently as Venitramanan's successor Dr C. Rangarajan took the financial reform agenda further forward in many critical areas, including especially the ending of automatic monetisation of the government's deficit.

* Address by the Hon'ble Prime Minister Dr. Manmohan Singh at Grand Finale of the Platinum Jubilee Celebrations of the RBI at National Centre for Performing Arts, Mumbai on April 1, 2010.

As with economic reforms in general, financial sector reforms in India were implemented at a gradual pace. We were often criticised for our incremental approach which critics often complained was far too slow. But few would deny that we have accomplished a great deal over the years and Reserve Bank has made important contribution towards this. We have successfully eliminated stifling controls on industry and investment. We have opened the economy to foreign trade, lowered tariffs and switched over to a market determined exchange rate. We have liberalised capital controls enabling the economy to absorb substantial inflows of capital in the form of both FDI and FII flows into the stock market. In recent years, foreign investment has also become a two way flow as many Indian companies have established a presence abroad through investment or acquisition.

All of this has been achieved without experiencing a serious macro economic crisis or severe inflation over an extended period. Most importantly, the real economy has clearly prospered. The rate of growth of GDP has increased steadily over the past two decades, culminating in an unprecedented 9 percent growth per year in the four year period just before the global financial crisis. Poverty too, has declined steadily, though this is an area where much more remains to be done.

The Reserve Bank of India has played a major role in this transformation. It has been a lead player in banking and financial sector reforms and has acted as a confidential adviser to the Government on many other issues relevant to the complex task of macro economic management in an increasingly open and liberalised economic environment. Indeed, it is one of our great institutions of which we can all be truly proud.

The past two years have been difficult years for governments and central banks all over the world. Excessive credit expansion and asset price inflation both fuelled by so-called "financial innovations" of dubious value, and a lax regulatory environment led to an accumulation of risk that was not adequately understood and ultimately produced a severe crisis.

India was relatively insulated from these developments because our financial system was much less integrated with the global system. However, the RBI deserves credit for having been prescient about the dangers posed by property bubbles. The action taken by Governor Reddy, who is present here, well before the crisis to tighten bank credit against real estate, limited bank exposure on this account.

When the crisis exploded in September 2008, the RBI rapidly reversed its earlier tightening of credit to meet the new and changed circumstances. The CRR and the repo and reverse repo rates were rapidly lowered in a series of quick steps. Some initiatives were also taken to enhance access to bank credit by Non Banking Finance Companies. Signs of panic withdrawals from some private sector banks in the initial weeks of the crisis were met with strong reassurances by both the Government and the RBI that our banks were sound and would be fully supported.

Ensuring that the Indian financial system remained stable in these very difficult times was a major achievement in financial and economic management. I would like to compliment Governor Subbarao and his team at the RBI for the role they played in this period.

With the crisis now nearly over, we need to reflect on the challenges that confront us in the years that lie ahead.

The industrialised countries are almost certainly entering a period of slower growth. India on the other hand is emerging stronger, with a good prospect of better performance in future. Our domestic savings rate has increased to around 35 percent and our domestic investment rates are around 37 percent of our GDP. We have a highly entrepreneurial private sector which has demonstrated that it can compete in global markets, not just in software but in areas of traditional manufacturing also. We have a critical mass of human resources with good quality higher education, which definitely places us at an advantage in today's world. We are geographically located in a continent which is gaining in economic importance and looks like being a major driver of the world economy in the years that lie ahead.

We must build on these strengths and return as quickly as possible to a high growth path. I believe we can get back to 9 percent growth path by the end of the Eleventh Plan and do even better thereafter. I have therefore asked the Planning Commission to explore the feasibility of achieving 10 percent inclusive growth in the Twelfth Five Year Plan.

Achieving this outcome will require many policy changes. Let me comment briefly on those that concern the Reserve Bank.

As we pursue our objective of achieving rapid and inclusive growth, our monetary and financial policies must be guided by three important objectives. First, they must ensure that inflation is kept under control since it hurts the common man the most and also distorts economic signals. Second, they must ensure stability of the banking and financial system since otherwise we run the risk of experiencing financial crises which always impose high costs on the real economy as well. Third, they must meet the financial intermediation needs of rapid and inclusive growth.

Monetary and financial policies can achieve these objectives efficiently only if the macro economic environment is sound. The size of the fiscal deficit is a key parameter in this context. We allowed a large increase in the fiscal deficit in the past two years as we responded to the global economic crisis. I compliment my colleague and friend Pranab Mukherjee for this. This must now be reversed. We are therefore, firmly committed to bring the economy back to a fiscally sustainable path. This involves a reduction in the fiscal deficit from 6.8 percent of GDP in 2009-10 to 5.5 percent in 2010-11 with a further reduction in the next two years reaching 4.1 percent in 2012-13.

It will be much easier for monetary policy to control inflation if the fiscal targets are met. This is not to say that monetary policy has no role to play in the face of fiscal imbalance. However, its role in that situation is essentially defensive, of avoiding monetary expansion to accommodate the deficit since such accommodation will only stoke inflation.

The problem is that monetary discipline in such a situation may help contain inflation but it will not offset the negative impact of large fiscal deficits on the availability of resources for private investment, or on the long term interest rate, both of which are critical for growth.

In fact, in an economy open to capital flows, monetary discipline in the face of fiscal imbalances can lead to a rise in interest rates triggering excessive capital inflows, which in turn put pressure on the exchange rate, making the task of macro-management that much more difficult. This is the well known problem of the impossible trinity or trilemma. In an economy with capital mobility you cannot simultaneously have exchange rate stability and an independent monetary policy. The responsibility for handling this delicate balancing act falls on the Reserve Bank of India. Its task is made easier by the fact that the capital account is not entirely open and there are restrictions on inflows of debt, especially short term debt. Caution in the pace of opening the capital account has been a conscious feature of our policy, and there are good reasons to continue with this approach.

The second objective I mentioned is the need to ensure financial stability. There are important lessons to be learnt from the recent crisis in this respect. Financial regulation must be designed to avoid excessive risk taking keeping in mind that banks must protect their balance sheets from cyclical variations. We must be particularly watchful of regulatory loopholes which can create systemic risk. Micro prudential regulation which focuses on the stability of individual institutions has to be supplemented by macro prudential considerations, which relate to the stability of the system as a whole.

All these issues are being examined in the Financial Stability Board which is the key multilateral forum for evolving an agreed architecture of financial regulation. As members of the G20, we are now full members of this Board and are represented in that body by the Reserve Bank of India. The Bank must ensure that our concerns, reflecting our constraints and special circumstances, are fully reflected in the new international consensus that emerges out of the deliberations of the Financial Stability Board.

This brings me to the third objective of ensuring that the financial system meets the intermediation requirement of rapid and inclusive growth. This is in some ways the most challenging task before us. Our financial system has proved to be stable, but that does not mean that it does not need further development and refinement. I sometimes hear it said that our insulation has served us well and we should therefore avoid experimentation and further liberalisation in this sector. This I fear would be the wrong lesson to learn from the crisis. We must not draw the conclusion that financial innovation is not important in our situation.

Our banking and financial system is still relatively small compared to the size of the economy and there are many dimensions in which it must develop to enable it to support the higher rates of economic growth we are now aiming at. These higher rates of growth will occur in an economic environment in which India will remain open to the world and Indian companies will operate globally. Management of foreign currency risk will be an increasingly important concern in future and the financial system must provide our companies with the instruments they need to manage these risks at reasonable cost.

Similarly, rapid growth requires massive investments in infrastructure and much of this will have to be funded through long term debt. Banks are not ideally suited to provide long term debt and this underscores the need to develop a domestic corporate debt market. This too requires a conscious plan of action.

Finally, for growth to be truly inclusive, banking must reach out to many more people than it reaches now. Technological changes in the form of Information Technology and mobile banking greatly expand the potential reach of the banking system. The Reserve Bank has already shown commendable flexibility in allowing the system of banking agents to develop. It must remain committed to further expansion of banking services so that banks can touch the lives of more and more of our ordinary people. Our banking system must never lose sight of credit needs of our farmers, the small and medium industry and other priority sectors. We have a long way to go before the benefits of financial inclusion reach the worthier common man.

The Reserve Bank has served our country with great distinction in its seventy five years of existence. I conclude with the prayer that the best is yet to come and that its next seventy five years will be still more productive and still be more creative for our great country. I wish the Reserve Bank of India and its staff all the very best for the future.