

Lessons from financial sector reforms

Indian economic growth I

- Estimated long run potential growth is 7-8%
- Big boost to potential growth in 02-07
- Stagnant or possibly declining since 08
- Longer term increase in potential growth primarily explained by growth of capital stock & productivity
- Key question how do we boost growth to this potential as well as push up the potential

Financial sector I

Banks and Markets in the Indian Economy

		(Trillion Rupees)
	Non-food Credit	Cospi Market Capitalisation
June 1990	1.0009	0.4865
September 2011	38.7	68.05
Change (times)	38.6	139.8767

Financial sector II

- One element of finance i.e. equity market considerably liberalized and reformed
- Entire equity market eco-system namely
 - Private equity investors
 - IPO market
 - Liquid secondary market with electronic trading, competing exchanges, nationwide anonymous electronic trading
 - Risk management at the clearing corporation;
 - Derivatives trading comprising exchange-traded derivatives and offshore OTC derivatives
 - Mutual funds
 - Stock market indexes, index funds and index derivatives
 - Few barriers for domestic participants other than pension funds
 - Convertibility for ‘foreign institutional investors’

Reforms in securities markets I

Features	1992	2009
Regulator	No specific regulator, but Central Govt oversight	Securities and Exchange Board of India
Form of Securities	Physical	Dematerialised
Regulatory Approach	Merit based regulation	Disclosure based regulation
Access to Market	Granted by the Central Government	Eligible issuers access the market after complying with the issue requirements
Disclosure	Voluntary, vague, scanty and non-standardised	Standardised, systematic and at par with the international standards.
Pricing of Securities	Determined by the Central Government	Determined by market, either by the issuer through fixed price or by the investors through book building

Reforms in securities markets II

Feature	1992	2009
Exchange Structure	Mutual not-for-profit exchanges	For profit corporate, demutualised exchanges
Trading Mechanism	Open outcry	Screen based trading system
Settlement Cycle	14-days account period settlement, not adhered to always	Rolling settlement on T+2 basis
Risk Management	No focus on risk management	Comprehensive risk management system
Derivatives Trading	Absent	Wide array of exchange traded derivatives such as Futures & Options on indices & select securities & Futures on interest rate available. Trading in exchange traded currency futures.

Lessons from financial sector I

- Major reforms i.e. 10 laws in 12 years with demonstrable & palpable benefits
- Create deeper & liquid markets
- With a good quality OECD type regulator
- Foreign capital played an important part
- When it is broken don't repair but start anew
 - New legislation
 - New institutions

Lessons from financial sector II

- Technology is key
- Do not waste a crisis
- Incorporate global experience & standards
- Expert committee recommendations

Indian economic growth II

- Deeper product & factor markets
- Open up to foreign capital & competition
- Benchmark to global standards
- Institutions and state capacity
- Governance