Indian Economy: Some Contemporary Perspectives
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Lecture 24
Indian Economy-Financial Sector 6

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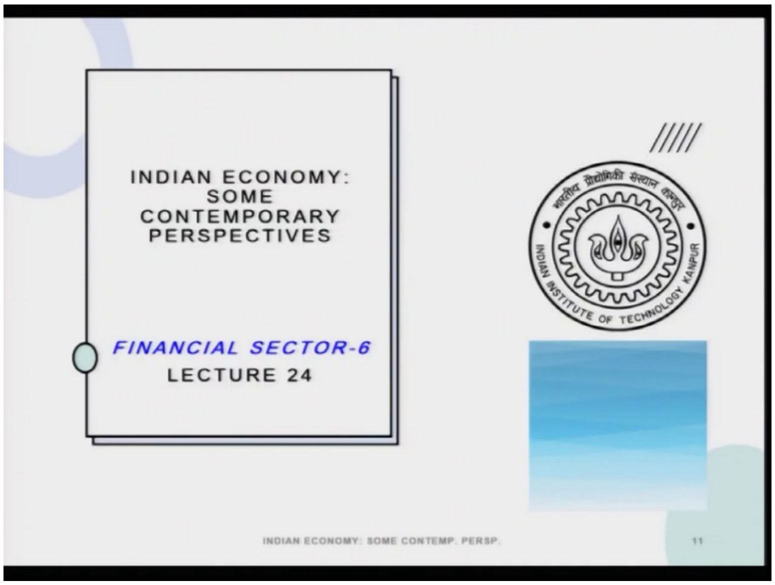

Yes, so let us in come back so we were talking about the major recommendations of a FSLRC and now we will be talking about the capital controls under that. So, this is lecture 24 of this particular course Indian Economy Some Contemporary Perspectives. And we are talking about financial sector reforms.

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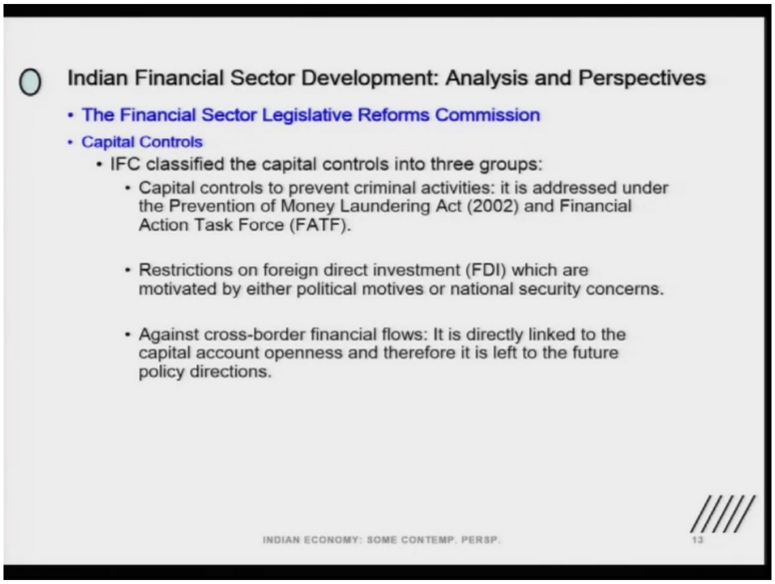

So, the readings remain same the economic survey an article of Patnaik and Shah that I mentioned. So, the readings will remain the same like a last lecture.

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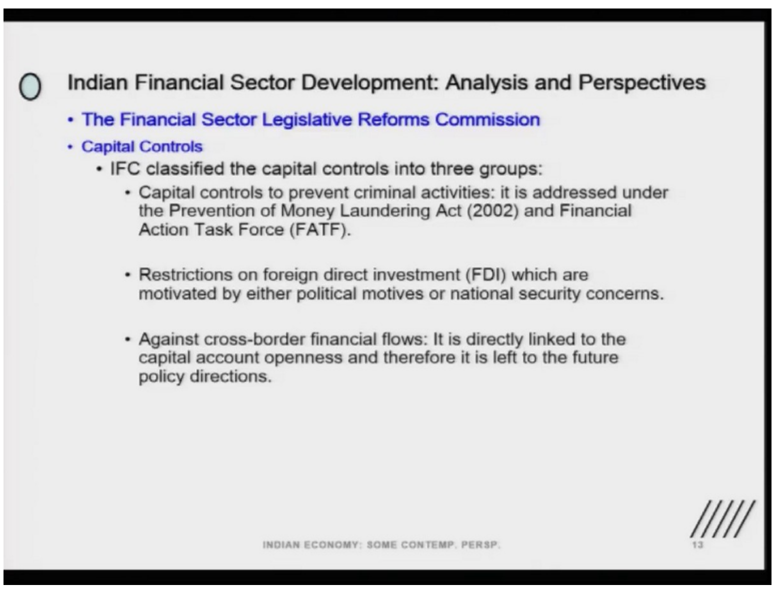

So here it mentions about the, so we are talking about the capital control. So, under capital controls though Indian financial code has also looked into the perspective of cross boarder inflow and outflow of capital because we have been part of the global task force that is called financial action task force and this task force has 200 members, 200 countries signing on this agreement saying that how they can avoid the financial flows to certain activities which are a dangerous to human existence for example, terrorism and all.

So, it has been there and this FATF force has also given instructions to all the central banks, all the financial authorities across globe to monitor the moment of capital for the sensitive activities. Then we also have the prevention of money laundry and act it was pass in 2002 but implemented in 2005 and then there are subsequent changes in 2012 also there was some changes and 2019 also some changes were suggested.

But this particular act helps the government in terms of taking actions on any illegal flow of money or any financial fraud that happen. So IFC also puts a check on this that when we are talking about the inflow and outflow of capital, then we should also be putting check there should be a regulatory body to check on the flow inflow and outflow restrictions on foreign director, direct investment which are motivated by either political motives and national security concerns.

For example, due to our geopolitical developments which China and even Pakistan we have a certain regulation put on check for investment coming from Chinese companies into the Indian equity market in the form of either portfolio investment or if it is more than 10 percent it would becomes FDI. So, if we have that kind of regulations we have a that kind of flow capital then how we can safeguard.

So, if the foreign capital is having some kind of national security concerned then this IFC has a complete I would strategies to deal with. It also talks about cross boarder financial flows. It is directly link to the capital account openness which means that we have already discuss the Tarapore-1 committee and then Tarapore-2 2006 report. In Tarapore-2 it was also recommended that until and unless we have micro stable, micro economic fundamentals.

Then only we will be going for implementation of such schemes of capital or account openness because it will have adverse impact on the not only domestic currency but also in terms of financial stability. So, rupee value may become quite volatile and it will be very difficult for central bank to control. So, since capital account openness is not fully materializing in case of India. So, it is left to the discussion for the and it has some kind of future policy directions.

So, in case in future if you are going to have the capital account openness, capital account convertibility then of course at that time there are scope for certain amendments in the IFC recommendations. But one good thing is that IFC recommendation is so detail that it considers the cross boarder flows and if you remember we had the foreign investment committee that has recommended such type of measures. That is why it is important to discuss here.

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Then, one sub component of the FSLRC commission is also about the monitory policy because this monitory policy is important because in this set up what is more important that instead of only targeting inflation if the low inflation is the only objective. Then in some cases what we find that the central bank is not able to achieve certain objectives. And that is why it is required that there should be a particular direction given to the central bank to focus on the monetary policy perspective.

So, there is some kind of independence required for the central bank to keep in mind but for the first time the IFC. So, this is a conventional wisdom that we should have a more freedom to the or we should give more freedom to the central bank. But IFC it was recommended that finance ministry will come into picture and finance ministry will decide about the objectives and will pass on to the RBI and the central bank will be following that.

And banks will have the independence in terms of implementing these objectives. The decision about the Repo and Reverse Repo will be completely taken by the monetary policy committee. So, based on the FSLRC recommendations we have a monetary policy committee right now the members Doctor Ashima Goyal, professor I G Dr, then we have Shashank Bede from the NCAR, and then we have Jayanth Verma from Indian Institute of Management Ahmedabad.

So Indian Institute of management Ahmedabad and Ahmedabad we have Jayanth Verma so these three members are nominated by the finance ministry or you can say from the government and then we have the governor deputy governor and some other members from the RBI side. And they decide about the Repo rate or the Reverse Repo rate cut that we see always. So, Repo rate cut is basically now has become part of the monetary policy committee.

So, there is a controversy about this that whether we should go for such type of composition where there is a say of government also. So, you have a four are against use on this. So, four such that since the government becomes answerable when we have the higher inflations and central bank is quite reluctant in deducing the rate of interest. So, it is always better that there should be some coordination.

And the against few is that if you are going for giving more power to the monetary policy committee which means that the government is dictating in the jurisdiction of RBI and the central bank. And it is always better that central bank should be given complete freedom in terms of tackling inflation. So that they will be a special (7:34) power for the central bank to act against any kind of on toward events due to rise in general prices.

So, this particular dimension is always debated in this case you may be going through the opinions publish in leading dailies and these opinions are often having an either for or against few. So IFC has given this recommendation and I think that is why monetary policy committee came into existence.

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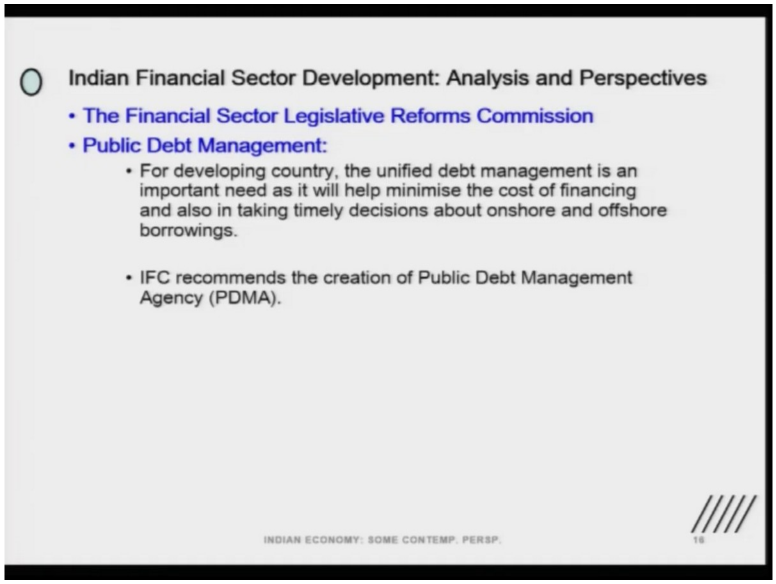

So, this what and then we have the public debt management. Public debt management is one area where we feel that the government is also having very difficult time. So, since we have the fragmented structure and this fragmented structure sometime does not allow the government to efficiently to look for the borrowing. The efficient borrowing is means that the low-cost borrowing or even in terms of management of the debt.

So IFC recommend that there should be a public debt management agency and this agency will synthesize the information coming from the central bank from the government ministries. And it will try to bring one cohesive direction for the public debt management. So that if the government needs money and if they want to borrow then they can simply go and borrow from the difference source.

So, this particular public debt management it is also going to consider whatever onshore and offshore borrowing happen between government and external agencies.

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Then we have the development and re-distribution. This particular task for the first time the FSLRC has given such unique recommendation. It is about the missing markets, missing markets in the sense that since it is independence since we have gone for the promotion of the government sector heavily. So, there is a lot of faith on the government sector and even individuals they do not bother so much about the investing that is why we have the well development government bond market.

And even the institutions are having some kind of obligations to invest some amount of money. So, it is mandatory for those institutions to invest and that is why it has become like one of the well diversified market. But this is not the case for the, for example corporate bond market because people have limited faith. There is an issue of disappearance so which means that after some years from sub have completely gone missing.

And it has become really difficult to trace and that is why the people have very low faith, low regard to the corporate bond market. And that is why even institutions are not empowered so much to invest in that. So, under IFC there is a particular dimension to develop those missing markets and create some kind of level playing field for both corporate plus the public sector. And that is why it is very IFC empowers the finance ministry as a nodal agency to implement and enact the market development schemes.

Which means that the subcomponents of the either missing markets as I gave you the example of corporate bond market finance ministry will look after. Finance ministry will also collect the data and make it available in public domain after every three years. Which means that if we have an if the government has taken any initiative with regard to development a particular market. Then finance ministry will have some kind information collections.

So that it can be further analyze and further recommendation can be provided. financial authorities will be task to implement these schemes and will be accountable to ministry of finance. So, it means that this particular regulatory authority will be given of some kind of responsibilities in terms of implementing these schemes. So, for example we have national saving certificates.

So, post office takes care the investment in that particular instrument in the same way for the development of the private sector bond market or the private sector bond placements. That there will be some agency designated nodal agency and this will be reporting to ministry of finance.

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Then we have the last one, last it is called contracts trading and market abuse. And contract trading and market abuse becomes really important to understand and in this process one of the important things is that once we go for enactment of or introduction of any policy, any regulation there must be some kind of clarity. There should not be any overlaps, so in case of India in some cases it has happened that there is a launch of a product which looks as similar to the jurisdiction of the SEBI.

And then we have an insolence regulatory development authority and then you have the confusion that which regulatory body should regulate the product. And as a result, some confusion with regard to whether it should go to the SEBI or it should go to the IRDA. So, in India we have the RBI, we have the SEBI, we have the insurance regulatory and development authority IRDA, then we have the pension fund regulatory and development authority PFRDA.

Then we have the foreign market commission under foreign market commissions under we had convertive regulatory but now it has moved to SEBI. So, these are the regulatory institutions which consider the banking system, the stock market, insurance product, then pension fund, and foreign market commission that we dealing with the other industries under the ministry consumer affairs.

So here if these are the regulatory bodies then what should be the firm of contract enforcement or if there is any kind of event of market abuse which means that there is a dominance of a one popular particular firm along the overall other firms then if there. How these institutions will react? So, this talks about that so under IFC they under Indian financial code so the recommendation is that RBI will have the jurisdiction complete jurisdiction in conduction the monetary policy.

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So, the monetary policy should go to the RBI completely banking regulations, consumer protection, micro-prudential laws, and the regulation of the payment system. So, all these are part of the RBI and there is a, there is recommendation to create unified financial agency, unified financial agency will take over SEBI, IRDA, PFRDA, and the foreign market commission. And this unified financial agency will have the coverage of stock market insurance pension plus the other products under foreign market commission.

So now as per the IFC since it creates lot of confusion there is difficulty in maintain the arm length distance among these SEBI, IRDA, PFRDA and FMC. So, these institutions will be merge into one which will be called as unified regulatory authority UFA. And UFA will monitor the consumer protection micro-prudential laws except banking and payments because banking and payments are part of the RBI.

So, RBI is now as per the IFC RBI takes care the consumer protection. UFA will also have the authority to monitor the organized financial trading of the RBI, organized financial trading it means that the trading are bonds which we have the Gelte security market which means that open market operations whatever securities are being transected it will be taken care by the UFA even in case of forex market exposures.

UFA then will have full regulatory control on equities government bonds currencies commodities and the corporate bonds.

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Which means that IFC now it is giving you the complete idea about where to and how we can go about it. The securities appellate tribunal will be merge into the financial sector appellate tribunal. So as if now we have the insolvency and bankruptcy code under that we have the company law have appellate tribunal. Now here in this case it recommends to have the financial sector appellate tribunal. And FSAT will hear appeals of regulatory actions of the RBI appeals of UFA appeals of financial redress agency.

So, there is now going to be imbursement on all the regulatory bodies. So, UFA and the central bank under IFC and this FSAT will take care the concerned of RBI then it also takes care the concerns of UFA. It will also take care the concerns of financial redress agency that we have already discuss and appeal of implement of the work of the regulation corporation. So, the regulation corporation which we talked earlier that how this particular institution is going to be playing a role.

Deposit insurance and credit guarantee corporation will become part of the resolution corporation which means that if any investor is feeling cheated or if the investor is not being given the due process in terms of settling of the contract. Then this so the deposit insurance and credit guarantee scheme it basically takes care that if we have deposited your money in the bank and in the failure in the event of the failure of the bank.

There will be some insurance attach and you will be paid. So, in India its around 1000 rupees. So, whatever is the amount if the bank fails will be getting that money. The FRA will provide consumers a single venue to laws complaints against all financial firms. So, this is going to be one area where it is important public debt management agency will act as a government investment banker.

And cash manager which means that this particular institution will unify the whole lot of borrowing or debt management scheme so that in the event when the government is willing to borrow money it will give sufficient options or provides sufficient root. So that it can be process quickly the role of FSDC will exist with it function FSDC framework specially dealing with systemic risk.

So, which means the essence the FSDC is going to important for maintaining the systemic risk in the country. So, this particular agency will play an important role in this.

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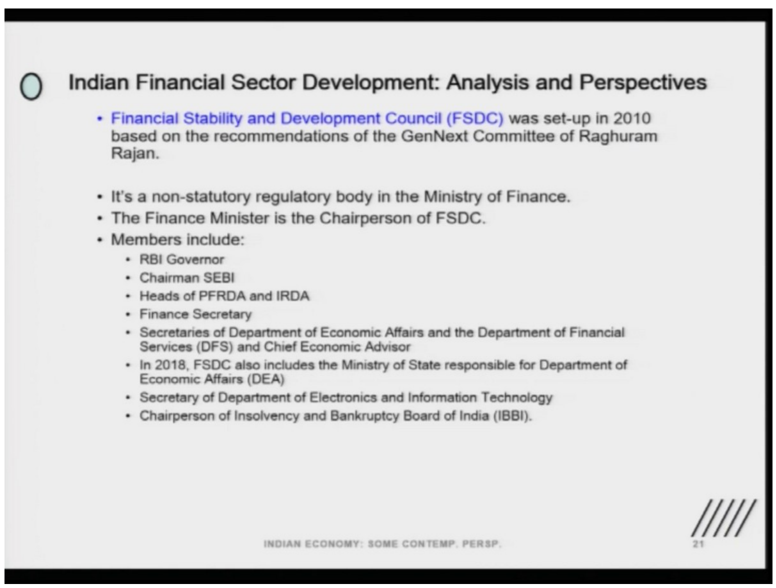

Now, let us talk about the financial stability and development council. So, each and every country if you search in the UK and even in US have the FRA financial regulatory authority in the same way after 2007-8 global financial crises. Now you have a certain development in each and every country where the central bank and ministry of finance and government have been instructed to set up some authorities wherein if they have any adverse situation.

Then they can take certain measures and reduce the impact of any external shock or even arising from the, or ever arising internally if they have internal shocks arising. For example, we had the Indian banking crises in 2016. And that was quite a lot and even in 2018 September 2018 we had the IL and FS crises that also created complete doldrums in the minds of the regulators and investors and then we had the PMC saga in Mumbai that has also deteriorated the confidence or sentiment of keeping money in the banks in the country.

So, in 2010 and just to mention if we go on the RBI website then you find that there you have the financial stability report. So, it is call FSR and after 2007-8 global financial crises the central bank is now being given task that they have to bring out after every 6-month 1 report. And that will give us the idea that what is the financial health of the banks operating. So, this particular report gives you complete idea about the banking system.

How and to what extent the banks are facing problem and if they are good then to what extent they are good. What are the good scenarios bad scenario there are certain mythology they discuss stress testing and all. So those are regulatory, those are regular activities that supposed to be done by the central bank and now because of the 2007-8 global financial crises it has become core acts of the central bank.

Now if you try and discuss the financial stability and development councils then FSDC it is a non-statuary regulatory body in the ministry of finance. And the finance minister is the chairperson of the FSDC. RBI governor and members are the RBI governor then here you have the chairman SEBI. Then heads of PFRDA pension fund regulatory development authority, insurance regulatory development authority finance secretary.

Secretaries of department of economic affairs and the department of financial services and chief economic advisor. So, in FSDC chief economic advisor is also one member in 2018 FSDC also includes the, included the ministry of state responsible for department of economic affairs. So, DEA so now we have one more addition. Secretary of department of electronics and information technology.

Because now we have the collection of information database management and how this database management will be put into completely at in safety norms and how it can be accessed. Which all authorities will have the access to that crucial data. So, to keep that in mind department of secretary of department of electronics and information technology is also part of. Now we have one newer agency in India right now.

So, we have now insolvency and bankruptcy board of India IBBI and it was set up in 2016 on October 1. So, this particular body chairman is also because this particular body has been set up to take care the corporate insolvency resolution process. And it has been a quite a success because earlier we did not have such type of institution to tackle with. So even firms which were making losses they had no idea when they can approach.

And where to approach so RBBI is a particular body interested or given or has been given toss to look after the bankruptcy and the insolvency cases in India. And comes under insolvency and bankruptcy act. And that is why this FSDC becomes really important because it talks about the systemic risk that we are talking about. Now going to ahead I will be talking about how we can go for further I would designed and development.

And then we will be spending more time now after this. So, we have discussed this FSLRC commission. So, under FSLRC commission one good has happened. So now it is time to recap a bit so in this particular session we have covered almost all the sub component of the FSLRC commission. We have also discussed in detail that how detail is the FSLRC recommendation and to what extent we can understand the role.

And the beginning when we were talking about the banking sector reforms then our focus was just to have the banking sector and how we can regulate. And how government can give certain targets and how those targets can made by the banks. Then came the era of 1980s we were still not doing good at that time we also had to go for nationalization. Then we had the 1991 period where we had gone for the economic liberalization.

And economic liberalization gave the boost to the financial sector and then we had to open our economy. And then services sector boom started and this service sector boom lead to the creation of the new middle class. The emerging middle class and that created a demand for lot of financial products and these financial products again gave boost to the financial sector as a whole. So, we had to go for expansion of our equity market.

We also developed our foreign exchange market. We also had a, we also had the commodity market. We also now have the trading in almost all sphere except rites I think rites are not now restate investment. Investment trust are not part of then we had the fund management beneses flourishing because we have the mutual benes is leading over all other sectors. Then we have then we had the non-banking financial companies taking over.

And have also provided sufficient liquidity to the financial system. So now we in the situation where we have to look for not only the expansion of the sector. But we also have to look for certain benchmark's certain rules and regulations through which we can monitor these institutions continuously. And since the sector has expanded so much that there is a risk of contagion that if we have a something happening in US and because of that if you have a spillover coming to India.

Then it will have a negative impact and certain firms and those institutions which are directly link to the US market may be adversely impacted. So, to keep that in mind for the time this FSLRC report had they recommended the Indian financial code and under Indian financial code we had the whole lot of regulatory frameworks and also to how to deal with the adverse situations.

One of the reasons why I discuss that committee report so extensively that for the first time we had gone for such type of recommendation and some recommendations are already implemented, some are under process we go on the RBI if you go to the ministry finance website. Then you will find that this particular commission report is being mention separately with certain changes. There is formation reformation of certain committees to look after.

So, it is expected that going ahead in 5 to 10 years we will have some recommendation picked at from this particular committee's report and it may become part of the main regulatory structure that we have in India right now. So now after this we will be now talking about the Indian banking crises that what lead to the Indian banking crises.

What were the reasons so in a few minutes so we will start that session and then we will be having the clear-cut idea about that what is the, what were the reasons for the Indian banking crises? Thank you, thank you so much.