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from the RINGSIDE

Banking reforms: Need to walk the talk

Just before P Chidambaram left for the annual ritual of the World Bank and the IMF meeting in Washington he was rather optimistic in an interview to a prestigious economic daily. This was in contrast to his somewhat guarded statement at the launch of a recent book, India Financial Sector: Recent Reforms and Future Challenges edited by Priya Basu, where he confessed that lack of political consensus handicapped bold initiatives.

The area of financial sector reform is one area where Chidambaram needs to ‘‘walk the talk’’. It is nobody’s case that financial reforms initiated in 1991-92 have not made significant progress. In overall terms, banks are much healthier, customers are better served through improved technology and development needs more responsively met. The regulatory architecture has been strengthened by the creation of SEBI for securities markets and mutual funds, and the Insurance Regulatory Development Authority for the insurance sector.

The question which we need to ask is a different one. Are we satisfied with the pace of change? Is an average Indian convinced that his cost of credit does not bear the load of inefficient financial intermediation? Is there genuine competition and dynamism in banking? Is there enough aggressiveness to meet the needs of the agriculture sector; in rural India against the annual credit requirement of Rs 45,000 crores only Rs 2,000 crores is available? Are we enhancing the reach of the banking system in a country where 500 million individuals do not have bank account?

Chidambaram could not have forgotten that a roadmap on banking reforms was announced. Presumably it includes the following:

(i) Improving the autonomy and efficiency of public sector banks; minimising government interference and strengthening the quality of bank boards. With the exception of the Reserve Bank and the State Bank, the quality of other bank boards remains suspect. Political patronage is evident in abundance; successive governments have parked favourites on these boards. The wrongs of the past cannot be a good precedent for continuing them in future.

(ii) High quality talent with domain knowledge cannot be attracted by the present salary structure; the dilemma of market-oriented emoluments in a ‘‘public sector bank’’ needs resolution.

(iii) Strengthening accounting procedures, so as to fully reflect market values of all assets in publicly disclosed statements, and ensure that losses are fully revealed to shareholders, depositors and supervisors, regardless of whether they stem from NPAs or higher interest rates. A bank that does not honestly report bad news will never get around to solving problems.

(iv) The uniformity of practice relating to asset classification and adequacy of provisioning based on more truthful classification of assets is not easy. Indeed, while NPAs have significantly declined, some of the numbers remain suspect depending on how truthfully assets have been classified. The entire area of asset allocation, asset quality and capital adequacy needs to be re-visited. Methodologies for risk assessment of asset quality and provisioning in the light of the perceived risk is critical for meeting Basel II norms.

(v) The high fiscal deficit is cited as a reason for all manner of conservative policies in the financial sector and monetary economics. But it does not, in any way, constrain reforms in banking that are aimed at increasing competition. If government equity in public sector banks cannot be reduced (the initiative of the NDA Government to reduce equity to 33% did not travel far in their own government) and there is no consensus within the UPA, then the absence of competition will perpetuate inefficiency. Efforts towards consolidation, mergers and acquisition also remain stymied. It is in this context that the enhanced presence of foreign banks in India, and greater ease of entry for domestic banks, can greatly help in improving the productivity and efficiency of Indian banking.

(vi) The accepted roadmap for presence of foreign banks in India is in two phases; the first phase comprises of three components namely, foreign banks with first time presence choosing to operate through a branch licence or set up a 100% Wholly Owned Subsidiary (WOS); existing foreign banks expanding branches through a liberal branch licensing procedure; converting existing branches to Wholly Owned Subsidiaries or be allowed to have an equity upto 74% in private Indian banks identified by the Reserve Bank for re-structuring. During the last six months nothing has been heard or done on the implementation of this roadmap; either no foreign banks are eligible or they remain uninterested. This needs explanation.

(vii) A reform of the regulatory architecture by learning from the best international practice has received scant attention. Avoiding conflict of interest in regulatory institutions faces resistance coupled with complacency.

The roadmap for reform of the banking system has multiple objectives; quite a few require legislative action. There are others in the regulatory or administrative domain. The last one year has seen tardy progress. Promising reforms is less than adequate; the proof of the pudding is always in the eating.

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