Financial Sector Reforms And The Role Of Central Bank In India : A Post - Global Financial Crisis Perspective

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SECTION - A

INTRODUCTION

The very basis of this paper is to visualize and analyze the major role played by the Indian Central Bank in withstanding the storm of the economic downturn due to its persistent reformative efforts. The factual matrix of all major economies world over clearly depicts that there has been a sharp decline in the finances, and most of the strong economies have been under immense pressure to close down or reduce their financial operations to a considerable extent as they could not withstand the unforeseen crises in the past two years.

The repercussion of this global slowdown has had a bearing on a fast developing country like India too. During the year 2008-09, India's economic growth decelerated to 6.7 per cent. This represented an overall decline of 2.1 per cent from the average growth rate of 8.8 per cent in the previous five years (2003-04 to 2007-08) (Economic Survey, 2008-09). The global financial crisis and consequent economic recession in developed economies have clearly been a major factor in India's economic slowdown. Given the gravity of the crisis in the advanced countries, which some have called the worst since the Great Depression of 1930s, every developing country has suffered to a varying degree. No country, including India, remained immune to the crisis. However, there had been a minimal impact of this global financial crisis on the Indian banking and financial system, primarily because of the reason that the Indian Banks had very limited exposure to riskier assets and derivatives. The relatively low presence of foreign banks also minimized the impact on the domestic economy. All commercial banks met the minimum capital adequacy norms of 9 per cent (while the minimum capital adequacy requirement under the Basel Standards is 8 per cent) and throughout the crisis period, inter-bank markets for money, forex and debt functioned smoothly. The sudden spurt of the sub-prime mortgage sector in the USA in 2007 was the result of two important fundamental macroeconomic imbalances that persisted for too long. One was the loose monetary policy of the Federal Reserve in the Greenspan era, which had its role in supporting the growth of the two most unpleasant things- speculation and leverage- which in turn contained the potential for a severe financial crisis and secondly, the growing global imbalances. The global imbalances were manifested through a substantial increase in current account deficit of the US, mirrored by the substantial surplus in Asia, particularly in China and in oil-exporting countries of the Middle East and Russia. Countries around the world with current account surpluses or large foreign exchange reserves kept investing in the United States. Despite the crisis and the resultant forces correction in imbalances, this global problem persisted even after the crisis (RBI Bulletin, October, 2009).

The impact of the crisis in India, as in many emerging economies, spilled over from the real sector to the financial sector. Industry and businesses, especially the Small and Medium Enterprises (SME) sector, had to grapple with a host of problems such as, delay in payments of bills from overseas and domestic buyers affected by the global slowdown, increase in the stock of finished goods, fall in value of inventories, especially raw material, which in many cases were acquired at higher prices such as metal and crude oil based products. Reduction in capacity expansion due to fall in investment demand, demand compression by the employment intensive industries, such as; gems and jewellery, construction and allied activities, textile, auto and other export oriented industries. Hotels and Airlines, apart from the IT industry, also saw a fall in demand due to the global downturn. A three-way crisis knocked- First, the reduction in foreign equity inflows- especially Foreign Institutional Investors (FII) flows impacted the capital and forex markets and the availability of funds from these markets to domestic businesses. Secondly, the shrinking of credit markets

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overseas had the direct impact of tightening access to overseas lines of credit, including trade credit for banks and corporates. Both these factors build up pressure on credit and liquidity in the domestic market with the knock on effect and lastly, the fall in global trade and output also impacted consumption and investment demand. The cumulative impact of all this was a marginal fall in output and employment opportunities. (RBI Bulletin, August, 2009).

The financial markets today encompass not only traditional banking institutions, but also many other financial entities such as insurance companies, pension funds, mutual funds, venture capital funds and stock and commodity exchanges that perform the function of financial intermediation. This development has been accompanied by the advent of market-based instruments of the stock and bond markets, financial products such as asset-based securities, financial futures, and derivatives instruments. While reducing the dependence of investors on bank credit to fund their investments, these have also contributed to reallocation of risks and optimal utilization of the available capital. Financial markets also serve the need for greater financial inclusion. The recent experience from the global financial crisis, has however, shown that despite the variety of instruments and the sophistication of the markets, they may not remain immune to a crisis. If the investors/institutions do not pay adequate attention to the fundamentals, or if the pricing of risk and the ratings for these instruments are not transparent, and if the regulatory oversight is poor, then they may have to undergo chaotic financial losses. An efficient and healthy financial market should ,therefore, avoid the shortcomings as gleaned from the experience of the global financial markets in the last couple of years. The deepening and broadening of financial markets also underscores the importance of institutional safeguards for monitoring and analyzing the domestic as well as external developments to ensure that the regulatory system is efficient and effective (Economic Survey, 2009-10).

Finance and economic development are intimately interlinked. As the economy of a country grows and becomes more sophisticated, the financial sector has to develop in such a manner that it supports and stimulates such development. Impending globalization has integrated the Indian banking system and financial system to such an extent that it has strengthened its roots and managed to compete with the competitive markets the world over. Due to persistent and planned reformative measures initiated by the Indian policymakers for over a decade, there has been a substantial transformation and liberalization of the whole financial system. India's path of reforms has been different from most other emerging-market economies; it has been a measured, gradual, cautious and steady process, devoid of many flourishes that could be observed in other countries. The initiation of financial reforms in the country during the early 1990s was to a large extent conditioned by the analysis and recommendations of various committees/working groups set up to address specific issues. The process has been marked by 'gradualism' , with measures being undertaken after extensive consultations with experts and market participants. Two points in brief need a special mention here. First, financial reforms in the early 1990s were preceded by measures aimed at reducing the extent of financial controls. However, unlike the latter period, the earlier efforts were not a part of a well-thought out and comprehensive agenda for extensive reforms. Secondly, the financial sector reforms in India were an important component of the comprehensive economic reform process initiated in early 1990s. Whereas economic reforms in India were also initiated following an external sector crisis, unlike many other emerging-market economies where economic reforms were driven by the crisis followed by a boom-bust pattern of policy liberalization, in India, reforms followed a consensus driven pattern of sequenced liberalization across the sectors (Mohan, 2005). An important salient feature of the move towards globalization of the Indian financial system has been the intention of the policy makers to adopt best international economic practices. This is illustrated by the appointment of several advisory groups and committees specifically designed to benchmark Indian economic practices with international standards in several crucial areas of importance like monetary policy, banking supervision, data dissemination, corporate governance and the like. It is widely recognized that the Indian financial sector over the last decade has been transformed into a reasonably sophisticated diverse and resilient system. However, this transformation has been the culmination of extensive well sequenced and coordinated policy measures aimed at making the Indian financial sector efficient, competitive and stable.

Since there is a rich array of literature analyzing the anatomy of the reform processes per se, the story of policy reforms in the India financial sector since the early 1990s is quite evident. Several authors worldwide have also discussed the outcome of this process. The present analysis arises in the wake of the global financial crisis, and apprehensions for the need of policy reforms in the financial sector. The R. H. Patil Committee, the Tarapore II Committee, the Percy Mistry Committee and the Raghuram Rajan Committee reports were drafted and submitted when the recent global crisis had not unfolded. These committee reports evoked considerable debate. We have seen that India has managed to escape with relatively small damage from the severe impact of the two financial crises (South East Asian Financial Crisis of 1997 and the Sub -Prime Crisis) in comparison to the rest of the world. This may compel a serious thinker to examine whether it has something to do with the gradualist approach that the government and the Reserve Bank of India (RBI) have adopted. There is a need to look into the role of the central bank in governing and streamlining financial sector reforms and to bring about financial stability, when there are arguments that the RBI be made solely responsible for containing inflation in India.

The domain of analysis of this paper is, however, somewhat limited. This paper doesn't analyze all the four-committee reports on financial sector reforms. The role of central bank in maintaining financial stability and financial regulation in the wake of the global financial crisis is also seen.

SECTION - B

THE APPROACH TO FINANCIAL SECTOR REFORMS

Financial sector reforms have taken a new meaning all over the world. Until the global crisis, reforms of the financial sector meant deregulation. Today's truth is that, globally, reforms in the financial sector mean regulation and improving the quality as well as effectiveness of regulation. In moving forward, we must take into account both the global realities and the Indian context. The agenda for reforms in the financial sector is being led by a reaction to the distress in the financial sector and regulation failures that occurred in several jurisdictions. A note of caution is necessary, namely, the Indian experience may not be equally relevant to all countries. However, they may offer useful clues on some aspects relevant to the current debate within the socio -political and corporate arena (Reddy, 2010).

Since 2005, the Government of India, Reserve Bank of India and Planning Commission have all been showing considerable interest in this subject, as can be noted from the high-powered committees appointed by them to study and recommend reforms in different areas of the financial sector. In December 2005, the High level Expert Committee on Corporate Bonds and Securitization, known as the Patil Committee, submitted its report to the Ministry of Finance. In July 2006, the Reserve Bank of India's (RBI) Committee on fuller Capital Account Convertibility, known as the Tarapore II Committee, submitted its report, giving a time frame in which Capital Account Convertibility could be hastened. In February 2007, the high-powered committee on making Mumbai as the international financial centre known as the Percy Mistry Committee submitted its report to the Ministry of Finance. Soon thereafter, in August 2007, the report of the Committee on Financial Sector Reforms known as the Raghuram Rajan Committee submitted its report to the Planning Commission. Thus, there had been a spate of expert committees making their recommendations for reforming different aspects/segments of the financial sector. All these committee reports have evoked considerable debate (Patil, 2010).

The subject of financial sector reforms has assumed added importance in view of the recent global financial crisis of unprecedented dimensions. The possibility of a collapse of several large financial entities forced governments in major developed counties to bail them out. Governments the world over introduced relief or bail-out packages to save banking and financial institutions. From the world credit loss of $2.8 trillion in October 2008, US taxpayers alone spent some $9.7 trillion in bailout packages. The UK and other European countries also spent some $2 trillion on rescue and bailout packages. In addition, proposals for injecting money into banks included: buying shares of banks, or purchase of convertible bonds of banks in which the government would be paid interest, and the government will have the option to convert these bonds into equity (Dhameja, 2010). The rescue package was highly discriminatory, especially in the US, where as many as 181 small banks were closed down during 2008-10, but no big investment bank other than Lehman Brothers was allowed to fail. The adage of too big to fail holds true in the US.

There are several explanations and experiences in multiple proposals for economic reforms. A narration of India's experience is essential because our experience has some unique characteristic. It was described as unconventional and sometimes as conservative in the past, but of late, it is getting favourable comments. It is also timely because the agenda for reforms in the financial sector is being led by a reaction to the distress in the financial sector and regulatory failures that occurred in several world economies. Listed below are the major areas of reforms under consideration globally, with a brief account of the Indian economy.

1) Financial stability and protection of consumers of financial products are under consideration. RBI has already included financial stability, quality of service to consumers in addition to development through prioritization of credit and financial inclusion.

2) There is a general agreement now that in the past, the scope of regulation was restricted to banks, and that it should now be extended to non-banking as well as to the shadow banking system. The scope of regulations in India currently includes non-banking financial companies (NBFCs) in addition to insurance, pension and mutual funds. The RBI monitors and regulates deposit-taking NBFCs and the capital requirements are related to the nature of businesses as well.

3) Globally, there are proposals to treat retail banking as a public utility and in any case, to prohibit banks from undertaking excessively risky businesses. The existing legal provisions enable the commercial banks in India to do universal banking, with the RBI having considerable regulatory discretion in permitting investment in other financial intermediaries or in undertaking activities other than core retail deposit taking, lending and investing in government securities. The discretionary powers have been used to prohibit, restrict or permit non-core bank activities by banks.

4) All countries are reviewing their regulatory architectures. Two key lessons are driving this change: first, that the responsibility for financial stability cannot be fragmented across several regulators; it has to rest unambiguously with a single regulator, and that single regulator optimally is the central bank. The other is that there is a need for coordination across regulators on a regular basis, and for developing a protocol for responding to a crisis situation. In India, we have a host of regulators in the financial sector- RBI, SEBI, IRDA and PFRDA. In order to facilitate coordination between them, there is a High Level Coordination Committee on Financial Markets (HLCC-FM) comprising of all the regulators and the Finance Secretary. While the Governor of the Reserve Bank of India chairs the HLCC-FM, the Ministry of Finance provides the Secretariat. The hallmark of the HLCC-FM meetings and one that adds most value to them is that the meetings are informal and there is a free exchange of positions, views and opinions. There is a view that the HLCC-FM should be given a formal structure. While the formal structure will have the merit of enforcing accountability, the flip side is that it may make the forum excessively bureaucratic and detract it from other value adding features.

5) The regulation of financial innovations is an area engaging the attention of reforms at the global level in view of the experience with derivatives. There are two major areas under consideration in the debate now. One is to establish and certify the safety of the financial products, and the other one is to insist, as far as possible, exchange trading and centralize settlement in complex products like derivatives. In India, the instruments offered by the commercial banks should be explicitly enabled legislation and rules, or they should be specifically approved or should not have been disapproved by the RBI. As regards traded instruments, these are governed by the regulations of the securities regulator. It is not unusual for banks and market participants to intimate innovations and continue with them unless or until the RBI puts a condition or safeguards or prohibits them. The overall safety of the products traded in stock exchanges is within the jurisdiction of the securities regulator, but the regulatory framework governing monetary, government securities and forex markets vests with the RBI.

6) The diverse approach, with regard to the financial sector is at the center of the current debate on reforms. While monetary policy in India was considered as unconventional but largely successful ; the regulation of the financial sector by the RBI was often considered being excessively conservative and risk averse. The RBI did not fall in the footsteps of the rest of the world in rapid deregulation and complete integration of domestic financial markets with the global markets. In fact, prudential measures over the financial sector were used extensively to achieve the objective of management of the capital account. Similarly, prudential measures were a key element in managing large public debt and persisting the then prevailing approaches to regulate the financial sector and fiscal deficits. Both these were considered critical for macro stability.

7) There are continuing debates on the ideal approaches to regulate the financial sector, based on experience with global financial crisis. They are: **(a)** Counter-cyclical polices and **(b)** Macro-prudential approach. Out of this, the latter one is being recommended since the safety and solvency of individual institutions does not guarantee systemic stability . With regard to the micro-prudential aspects, the focus is currently on the enhancement of the quantity and quality of banking capital, the extent and quality of balance sheet items, the incentives to management in regard to risk taking, the dangers of principal based regulation, and the consequences of very large-sized financial institutions.

❖ **Proposals For Reform In The Union Budget For 2010-11 :** The performance of the financial sector in terms of its contribution to growth and stability is rated among the most impressive among the sectors in India. The proposals announced in the Union Budget for 2010-11 were in many ways a part of the continuing process. However, the continuity elements in ideas and actions relating to reforms have to be balanced with the lessons of experience gained from the global financial crisis and India's needs. It is necessary to view the current proposals as a mix of continuity and change in the given context. There are three major sources of inspiration for reforms in the financial sector that are currently under consideration. First, there is an expectation that India will follow the G-20 consensus on reforms. Actions of individual countries are also monitored in the G-20. Second, there is an overhang of reforms recommended by some committees appointed by the government on the subject. While it may be difficult for the government to totally dissociate from the committees' recommendations, the emerging new global realities require a more nuanced response to their somewhat dated suggestions. Third, there are several domestically generated proposals for reforms on the ground that the future needs of growth of the Indian economy warrant reforms in the financial sector. It is also said that the proposed reforms should advance the cause of financial inclusion and more broadly, inclusive growth. The proposals reflected the intension of the government as announced in the Union Budget for 2010-11. These related to **(a)** Establishment of a commission for legislative reforms in the financial sector **(b)** Establishment of a financial stability and development council **(c)** Issue of licensees for establishment of new banks and **(d)** Recapitalization of Regional Rural Banks.

It is imperative to view all these proposals and explore ways of making a success of these ideas of the government.

❖ **Commission On Legislative Reforms :** For the success of the proposed reforms, the following steps are desirable as :

1) There are several proposals made by RBI and other bodies which have been before the government and parliament, so serious consideration on these are desirable.

2) A study of the views of eminent domestic and global experts will help obtain a sound basis of the principles and approaches for reforms.

3) There is a debate on optimal framework for financial sector at a global level or cross border regulation, for instance - Tobin Tax. It may warrant legislation at the national level in the future. Therefore, the commission has to be futuristic, not a once and for all time bound exercise.

4) Priority and time schedule are important tasks while considering scope of the commission, because legal hurdles for an efficient financial system often lie outside the regulation of the financial sector.

5) Compared to the nature of the task involved in reforming direct tax legislation, the task of reforming the whole gamut of finance sector legislation is far too complicated. Any commission of this type would first like to have information on what are the government's considered decisions that should be incorporated in the new legislation draft bill.

❖ **Financial Stability And Development Council :** The Union Finance minister said in his budget speech for 2010-11 that *"with a view to strengthen and institutionalize the mechanism for maintaining financial stability, the government has decided to set up an apex-level financial stability and development council. Without prejudice to the autonomy of regulators, this council would monitor macro prudential supervision of the economy, including the functioning of large financial conglomerates, and address inter-regulatory coordination issues. It will also focus on financial literacy and financial inclusion."*

There are some serious concerns regarding this new super regulator, which can be elucidated as :

1) The RBI showed a matured approach and foresight to banking sector regulation and monetary policy formulation. It is because of this that the country could escape the meltdown of the financial sector. There are apprehensions that RBI's functional autonomy and independence will be compromised under the new set up.

2) There is a hope that the government will not do something that will seriously jeopardize the role of RBI in effective regulation of banks, Non-Bank Financial Corporations (NBFCs) and other financial institutions. Besides monetary policy, it has the ability to perform a role in evolving financial sector diversification and development, which the government would like to have in the future.

3) It may be useful to consider the logic behind the HLCC-FM. The HLCC-FM was expected to resolve any issues that may arise whenever there are possibilities of regulatory conflicts. The conflict between SEBI and IRDA regarding the

ULIPs show us that HLCC-FM has not been able to solve this conflict. It is not proper to say that HLCC-FM has failed in its objectives. Such problems cannot be solved to set up another body, until the Finance Minister directly intervenes in the problem. With a super-regulatory body headed by the Finance Minister, the government will be neglecting an evolving process, whereby the economy is moving towards an independent and mature regulator who will not be looking up to the government for day to day guidance or direction.

❖ **Banking Licenses :** In the Union Budget for 2010-11, the Finance Minister announced that the RBI was considering, giving some additional banking licenses to private sector players. Non bank finance companies could also be considered, if they meet the RBI's eligibility criteria : *" Such licenses will necessarily serve the developmental objectives announced in the budget and may potentially add to efficiency and stability of the banking system by inducing more competition. RBI may be cautious of the new license biz, because private banks lend little in government-sponsored programs-schemes that carry a slice of subsidy and are aimed towards job creation and poverty reduction. There are several studies and actions that could be considered to ensure positive results out of it. The Reserve Bank of India may soon allow Micro-Finance Institutions (MFIs) to set up banks. Reputed MFIs like Bandhan have already evinced an interest in floating banks and receiving public deposits. If MFIs are allowed to get banking licenses, then 25 million small borrowers will automatically come into the banking fold.*

The Union Finance Minister also said that, *"RBI has framed a set of guidelines for setting up new banks. Following my announcement in the Budget, the apex bank is now planning to allow new entities to set up banks and has recently floated a discussion paper. Interested parties and stakeholders have submitted their suggestions to RBI. The central bank will now finalize its view on the issue and soon allow new entities to take up banking activities."* (The Economic Times, 2010). The policy is a part of a broader plan for financial inclusion.

❖ **Recapitalization Of Regional Rural Banks :** Regional Rural Banks (RRBs) play an important role in providing credit to rural masses. The rural banks were last capitalized in the year 2006-07. In the words of the Finance Minister in the union budget for 2010-11 : *"I propose to provide further capital to strengthen the RRBs so that they have adequate capital base to support increased lending to the rural economy."* The capital of these banks is shared by the Central Government, sponsored banks and State Governments. It is not clear whether a license would be granted for injecting private capital and management into select Regional Rural Banks (RRBs). This could be in the form of public-private participation, by replacing existing sponsorship of public sector banks with the dynamics of the private sector to serve the rural areas in a limited jurisdiction. This approach can be the beginning of a decentralized, but focused development banking system in rural India (Reddy, 2010).

SECTION - C

ROLE OF THE CENTRAL BANK

As we contemplate the lessons of the crisis, the questions that arise are what is the evidence against the old model of central banking and regulation and what is the new model? What is the paradigm shift that is required? Nevertheless, there is a furious debate on the pace and shape of global recovery. Regardless of one's position on this debate, everyone agreed on one thing, which is that restoration of trust in the financial system is central to the pace and shape of recovery. What this crisis has witnessed is a massive breakdown of trust across the entire financial system. Trust in banks and non-banks, trust in central banks and other regulators, trust in credit-rating agencies and investment advisers, trust in brokers, dealers and traders, and trust in the financial arena, if not in the market system itself. This surprise and sudden crash of world economy has taught a lesson that financial stability cannot be taken for granted. We have learnt that financial stability can be jeopardized - if there is a threat to financial stability anywhere in the world, it is a potential threat to financial stability everywhere. We have learnt that financial stability has to shift from being an implicit variable to an explicit variable of economic policy. Central bankers around the world are clearly in the forefront battling the crisis. While they are clearly a part of the solution, questions are being asked about whether they were, in fact, a part of the problem. In particular, did they fail to see the crisis coming? Were they behind the curve in preventing excesses from building up? Did they neglect financial stability in their zealous pursuit of price stability? More importantly, did they behave like this because the accountability mechanisms were weak? To address these questions, one refers to three egregious failures attributed to central banks; first failure : exclusive focus on price stability, second failure : failure to prevent asset price bubbles, and the third failure : lightness of regulation. The net result of all this was that financial stability failed to receive the central bank attention it warranted (RBI Bulletin, October, 2009). The Reserve Bank of India is the central bank of India, entrusted with multi-dimensional roles such as:

1) Monetary authority of the country.

2) Price stability, growth and financial stability are its prime objectives.

3) As a role of monetary authority, RBI has responsibility for forex management and government debt management, both at the national and sub-national level.

4) It regulates commercial banks, cooperative banks (both rural and urban), financial institutions and non bank financial companies.

5) It has a developmental role to ensure inclusive growth, as policies on rural credit, small and marginal enterprises and financial inclusion form an integral part of its functions.

More explicitly, since 2004, price and financial stability were given greater weight because the poor are affected severely and instantly by instability, while the reform induced benefits of growth percolate to them with a time lag.

❖ **Steps Undertaken By The RBI To Maintain Financial Stability In India :** The Indian financial system is dominated by a vast network of commercial banks. Thus, as a preventive and protective measure, the Reserve Bank of India in mid 1990s, as a part of restructure reforms, instituted the prudential framework for governing banks, especially the commercial banks. As of April 2009, all commercial banks operational in India had become Basel II compliant. This change in monetary policy resulted in streamlining several growth indicators, increase in credit aggregates and asset prices to mention a few. Similarly, both direct and indirect instruments were used by the RBI depending upon the evolving circumstances. It gave justification to the counter-cyclical policies adopted by the RBI. The prudential measures and other controls over the activities of intermediaries in the financial sector have been harmonized with a gradual liberalizing of inflows and outflows. Limits have been imposed on exposure of non-residents to the corporate debt and sovereign debt markets, but these are periodically raised to reflect the growing integration of India, with counter-cyclical measures and management of the external sector. RBI had hinted at the need to consider a Tobin Tax and abolition of non-transparent channels of portfolio flow as early as in 2005. However, earlier in 2004, an innovative mechanism, namely the Market Stabilization Bonds was designed. This resulted in providing the government to play a significant role in the total amount of sterilization, and this resulted in indirect intervention in forex markets, as the government agreed to bear the cost of such sterilization bonds. This instrument along with active capital account management and other multiple instruments in regard to liquidity in money and forex markets helped the RBI in managing sudden excess capital inflows during a boom as well as the outflows on the capital account when the crisis broke out. Briefly stated, in the conduct of macroeconomic policy, the RBI moved in close harmony with the government for initiating the structural change as necessitated for economic development. The regulation of the financial sector is seen as one of the parts of the broader policy objectives of the nation.

❖ **Current Scenario :** Percy Mistry Committee report on MIFC suggested that the RBI be solely made accountable for containing inflation in India. It suggested that a revamped RBI should be constitutionally independent (with its Governor having the same status for Monetary Policy as the Finance Minister has for Fiscal Policy). It also suggested that SEBI be made accountable for all regulations that concern transactions in capital and derivative markets (which includes all bond trading, including G-securities, and all derivatives trading, including future/option contracts other than equity derivatives, that is, for interest rates, currencies, credit defaults, political risks and commodities) (Business Standard, India, 2008). The Raghuram Rajan Committee had somewhat similar suggestions. There are some critical views on these committee reports, and the need of the hour is to judge reform proposals for their logical strength. Several international initiatives have been taken in the recent period for formulating proposals for strengthening the financial system. The leaders of the G-20 met in London on April 2, 2009 and laid down the 'Global Plan for Recovery and Reform'. We will not go into the details of this, but one thing is important to say that the Central Bank of India has been on the same lines with reference to the suggestions made in those meetings. The RBI is conscious of the need to pay increasing attention to financial stability and to improve its skill in this area.

CONCLUSION

Financial sector reforms in India are not a result of boom-bust economic situation, but they are the part of broader policy reforms. Even if the fundaments of the Indian economy are strong, they are not immune to the global economic turmoil. In the wake of the globalization and liberalization scenario, India should examine its position, if the financial sector has to evolve for the future. Global realities and the Indian context must be appreciated when we move forward to reforms in the financial sector.

The global financial crisis has taught us several lessons. In India, the reforms in the fiscal and real sector should be in consonance with the reforms in the financial sector so that positive results can be drawn. With regard to the financial sector reforms, we hear a new mantra from senior government officials and influential academicians - which is to dismantle all the controls on cross border capital flows, go in for market determined exchange and interest rates, downsize the RBI's powers to that of a pure monetary authority, transfer all the market regulation powers to the SEBI and opt for free financial markets. Some of the suggested policies like total capital account convertibility and an unfettered growth of derivatives, foreign exchange and bond markets have a deep underlying philosophy that is anti-egalitarian. Markets alone are not going to be the solution to all our problems. We need different sets of solutions, so that broad-based industrialization and infrastructure development pull the masses of the population above the poverty line, and the financial sector should clearly serve as an instrument to achieve these objectives. The RBI has shown its mature position in the financial sector regulation and reforms. While considering a new set up to regulatory architecture, the status of the RBI should not be undermined and contracted.

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