Financial Sector Reforms: The Unfinished Agenda

M. Narasimham

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Published by
THE A. D. SHROFF MEMORIAL TRUST
"Piramal Mansion", 235, Dr. D. N. Road,
BOMBAY 400 001.

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OBJECTIVES

(i) Publication of one or more books in English, Hindi, and regional languages annually on some of the great builders of Indian economy aimed primarily at educating the younger generation in high standards of building the national economy as practised by those great entrepreneurs and placing the example of their lives for emulation by India's youth.

(ii) Organising one or more memorial lectures annually on subjects which were of interest to the late Mr. A. D. Shroff, namely, banking, insurance, and industrial finance, the subjects to be chosen in rotation, and the lectures to be delivered by persons eminent in these fields.

(iii) Awarding annual scholarship or scholarships to outstanding student or students in the field of management.

(iv) Instituting a prize to be known as The A. D. Shroff Memorial Prize for the student standing first in Banking at the Sydenham College of Commerce and Economics, Bombay.

(v) Doing all such acts, matters and things as are incidental or conducive to the attainment of the above aims or objects or any one or more of them; and

(vi) Without prejudice to the above charitable objects or any of them, the TRUSTEES shall have the power to spend, utilise and apply the net income and profits for the charitable object of education or such of the TRUST FUND for the TRUST FUND for the charitable object of education or such other objects of general public utility not involving the carrying on of any activity for profit as the Trustees may think proper, it being the intention of the SETTLOR that the income and/or corpus of the aforesaid charitable objects without any distinction as to caste, creed, or religion.

A. D. SHROFF (1899-1965)

A. D. Shroff's achievements in the field of business, industry and finance were many and varied. A large number of enterprises owe their origin and development to him. As an economist, his predictions have proved right over the years. Through the Forum of Free Enterprise, which he founded in 1956, as a non-political, educative organisation, he sought to educate the public on economic affairs. It was his firm conviction that a well-informed citizenry is the foundation of an enduring democracy.

George Woods, former President of the World Bank, paid the following tributes to A. D. Shroff:

> "In every age and in every society men must express anew their faith in the infinite possibilities of the human individual when he has freedom to develop his creative talents. For this is in large part how the message of freedom is passed from generation to generation. A. D. Shroff spoke eloquently in a great tradition, and thanks to him we can be sure that other great men of India will continue to speak this message in the unknown context of our future problems."

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INTRODUCTION

The A. D. Shroff Memorial Trust arranges annually a public lecture on Banking, Industrial Finance, and Insurance, by rotation, in Bombay. These were the three areas in which the late Mr. A. D. Shroff made significant contribution.

This year the lecture on Banking was delivered by Mr. M. Narasimham in September 1993. There could not have been a more appropriate speaker since he has served with distinction as Governor of the Reserve Bank of India. Among his numerous assignments is the Chairmanship of the Committee for Reform of the Financial System. This Committee focusses on the much-needed reforms in the banking sector.

The contents of this booklet are significant as the speaker has set out the unfinished agenda of the Committee's recommendations to be implemented.

The lecture has evoked great interest. We have pleasure in bringing out this booklet in the hope that the layman, the bankers, and the authorities concerned, will take note of the valuable suggestions made by Mr. Narasimham.

It is a matter of privilege for the Trust to publish this booklet.

NANI A. PALKHIVALA
CHAIRMAN
The A.D. Shroff Memorial Trust

Bombay,
December 6, 1993

Financial Sector Reforms: The Unfinished Agenda

M. Narasimham*

The late A. D. Shroff was truly a Titan in the world of Indian finance and his career and interests spanned almost the entire range of financial services such as the capital market, insurance and banking. Mr. Shroff was more than a distinguished financial expert. He was actively involved in the debate on macro-economic policies and the structural framework of our political economy. A firm believer in the vitality of free enterprise and of the role of the private sector within broad social regulation in promoting development he was a fearless and eloquent exponent of his ideas. He foresaw with remarkable prescience even then, what we with the wisdom of experience and hindsight have come to realise, that a centralised command economy and a pluralist democratic polity do not go well together.

Our efforts at structural adjustment of the economy which we began in the midst of the unprecedented financial and fiscal crisis in mid 1991 is based on the tenet that our objectives of self-reliant growth and social justice call for a change in attitudes towards and the forms of macro-economic management both

* The author is a former Governor of Reserve Bank of India and Chairman of Government of India Committee on Financial System popularly known as the Narasimham Committee. The text is based on the Annual Public Lecture delivered under the auspices of the A. D. Shroff Memorial Trust on 6th September 1993 at Bombay.

in respect of current problems and basic economic structure. The rationale for the new economic policy stems from the logic of our own experience over the last four decades where the economy has not grown to its full potential, where self-reliance is still a will o' the wisp and adequate progress has not been made in the basic social indicators. It also derives from the example of countries in East and South-East Asia where within the ambit of a broad and, by and large, benign state regulation and sometimes intervention, enough initiative was given to economic agents which helped propel these economies from a level of under-development not far different from ours to the ranks of newly industrialised countries. One need not, therefore, be defensive about our having realised the need for a different form of macro-economic management and structure with less reliance on imperative centralised planning and more in favour of indicative planning with its corollary of providing greater scope for decision-making at the individual level. Economic policy and structures have to be related to time and space and there is nothing in them that should be regarded as immutable. One is reminded of the quip attributed to Lord Keynes when faced with the accusation that he had changed his views, he asked in return: "When circumstances change, I change my views. What do you do Sir?" The acceptance that we need to discard some of our ideological baggage and refashion policies and structures more suited to the current internal and external economic environment is as appropriate as it is necessary.

In the last couple of years we have made significant progress in bringing the economy to a more even keel.

The subsidence of inflationary pressure derives to a large extent from a combination of demand management and improved supply availability especially of food articles thanks to successive good monsoons. The major structural adjustment efforts aimed at improving the supply side of the national equation and at improving the competitive efficiency of the economy have, of course, been in the area of industrial, trade and exchange policies. A good beginning has been made in each of these and in some areas, e.g., exchange rate adjustment, perhaps more than appeared feasible two years ago. Having said this, one has to add that what remains to be done is still considerable. There is certainly scope for further action in industrial liberalisation and company legislation. Similarly, scope exists for a more liberal trade policy and especially with respect to the tariff structure. Similarly, the beginning made in the area of tax reform based on the Chelliah Committee recommendations needs to be pursued with greater vigour. The two major areas where the thrust of liberalisation has made little headway are agriculture and labour policy. Agriculture is yet to have the benefit of deregulation and freed of various structural rigidities. Nor have we made any progress towards evolving an economically rational and socially equitable labour policy, which would help to reduce restrictive practices and open the way for both efficiency and, in the longer run, employment generation. It is, however, not on these aspects of structural reform but, on the subject of financial sector reform that I wish to offer some thoughts, given the late Mr. Shroff's intimate association with this sector.

The rationale for financial sector reform was set out by the Committee on the Financial System, with which

I had the privilege of being associated and which submitted its Report a little under two years ago. Briefly stated, the rationale for reform was that the spirit of competitive efficiency that we are trying to bring about in the real sectors of the economy should cover the financial sector also if adjustment in the real sector has to be meaningful and, secondly, that the financial sector could undertake this task only if the system were healthy and profitable and, to be profitable and healthy it would need a considerable measure of operational flexibility and functional autonomy. Accordingly, the Committee put forward a set of recommendations dealing with various aspects of the functioning of the financial system and especially the banking system in what it viewed as an inter-consistent and holistic exercise. Since the submission of the Report, the authorities have taken several steps on different aspects of the recommendations but essentially the approach has been somewhat *ad hoc,* piecemeal and at times perhaps even hesitant. The approach is suggestive of incrementalism rather than a sequencing of reform as part of an integrated programme. I would like to suggest that the Committee's various recommendations should be compared with a jig-saw puzzle where the picture becomes complete only when all the pieces are in place and until such time a piecemeal approach to the problem would not help us to obtain the full benefits of the exercise. If I may vary the metaphor, this is a case where the whole would be greater than the sum of its parts.

To be fair, one can understand the measure of hesitancy in acting at a faster pace. This period has also seen the emergence of what is generally referred to as the scam in the financial sector arising out of irregularities

in the securities transactions of banks and other members of the financial services industry. One reaction to the scam is to say that financial sector reform should not be proceeded with on the ground that if this could happen within the framework of the present comprehensive regulatory system things could be much worse in the absence of such detailed regulation. The discovery of irregularities in securities and other transactions has shown that the present regulatory system despite, — some would say because of — its wide ranging, comprehensive and discretionary character was not able to prevent or control the edifice of irregularity that was being built. We had, as it now is apparent, an over-administered but underregulated system where detailed scrutiny was exercised on the minutiae of internal working of banks but the larger policy and procedural aspects impinging on productivity, efficiency and profitiability did not receive adequate attention. The scam, we now know, was the result of operational and organisational flaws in the system which were exploited by some individuals both within and outside the banking system to their personal advantage. It was both a systemic and a human element failure. Indeed the Committee on the Financial System had pointed out the dangers arising out of inadequate internal inspection and audit systems, the delay and inaccuracies in submitting returns to higher levels and to the supervisory authorities and the large number of unreconciled interbranch and inter-bank transactions, all of which provided a happy hunting ground for the fraudulent. Certainly, these deficiencies of the system need to be corrected on an urgent basis and those found guilty speedily brought to book. Serious efforts also need to be made to estimate what in fact has been the net loss to the system

and measures taken to retrieve on an urgent basis what is realisable. Incidentally, in all the noise about the scam and the losses believed to have been sustained by banks few voices are heard of perhaps larger losses incurred through the increase in non-performing assets caused by behest lending, loan melas and the like not to speak of the charge on the Exchequer as a result of the ultimate folly of loan waivers.

A fallout of the scam is an uneasy and somewhat widespread feeling among those who have to deal with the banks and financial institutions that decision making which even otherwise was a slow and tortuous process is now getting even slower. There is no such thing as totally riskless banking. Commercial risks are inherent in any credit decision. Given, however, the present unsavoury publicity regarding the functioning of some major constituents of the banking system, the officials of banks perhaps find it safer to say 'no' rather than take normal commercial risks in good faith and being accused at some later date of *male fides*. An atmosphere of mistrust and suspicion is not conducive to efficiency and when leading banks and their top functionaries are admonished in strong language and strictures passed on them by responsible bodies, a sense of insecurity bordering on demoralisation seems to have set in apart from the reputation of some of our biggest banks taking a knock both in the internal and even more importantly in the international financial markets. Frauds in financial institutions cannot be totally eliminated even as other criminal acts cannot, given human greed and avarice, but what one could legitimately expect is for systems and procedures to be in place which would help to reduce the scope and opportunities for fraud and enable early detection of them.

It is now being realised that apart from aspects internal to the system, there were also certain environmental factors that may have been responsible for the unfortunate happenings. This is not by any means to justify what has happened but to understand the forces at work. A system of administered interest rates and policies which came in the way of remunerative deployment of funds may have offered the temptation to banks and financial institutions under pressure to show better working results, to cut corners and indulge in arbitrage transactions and play the money and securities markets and in the process transgress not only lines of prudence but in some cases also of honesty and legality.

The trauma of the scam has thus, if any thing, emphasized the urgency of financial sector reform in areas of internal organisation and management of banks, the regulatory mechanisms and structural aspects of credit and monetary policies. It is an ill wind, they say, that blows nobody good. We should while learning the appropriate lesson from the scam put it also in perspective. Serious as it is, the scam is not the end of the world. Let it not allow our thought processes to be paralysed but spur us further on the road of reform. Financial irregularities do take place even in well regulated financial systems. These are detected and the guilty quickly run to the ground and the system allowed to proceed on its normal course. We need to do the same here and get on with the task of financial sector reform and process of creating an environment for the operations of the financial services industry which combines prudential regulation with adequate autonomy and flexibility of operations.

Among the steps taken so far, one should refer to the reduction in the SLR and CRR provisions, the changes announced in branch licensing policy, the notification regarding permission for the private sector to open banks, the proposal to permit some banks to access the capital market to augment their capital and the decision to appoint special tribunals for early recovery of dues to banks and financial institutions. Perhaps the most significant of the changes taken so far have been those in respect of accepting internationally recognised accounting standards and policies, income recognition policies, provisioning norms and capital adequacy requirements. This would make for the needed transparency and consistency in accounts instead of the earlier system which gave scope for what is euphemistically termed 'creative accounting.'

These changes are certainly steps in the right and positive direction but they still do not add up to a critical minimum effort. Even to get the desired results out of these actions certain other measures are needed if the effort is to be purposeful. Thus, some steps have not been logically followed by others. Let me take the example of the entirely correct decision to institute a set of transparent accounting standards and policies and provisioning requirements. The success in doing so would be greatly enhanced if banks were able to clean up their books. The Committee had, in this context, suggested a onetime operation whereby the contaminated portfolio of banks and financial institutions would be transferred at an appropriate discount to a new institution such as the Assets Reconstruction Fund. It is not that all the doubtful and bad loans

are totally irrecoverable. It is that, given our legal system, recovery is a long drawn out process. The acceptance of the Committee's recommendation with regard to special tribunals would certainly expedite recovery. The logic of the Committee's proposal was that once these assets were taken off the books of banks at a discount by the ARF and the difference between the book value and the discounted price on the books of the bank made good by Government injection of captial, the ARF in turn through the medium of special tribunals could hope to recover the amounts. One could even think of a variant of this whereby we could have these assets securitised and try to build up a secondary market for them with the ARF providing, if need be, a guarantee for such securitised assets. Unfortunately, there is no indication so far whether the recommendations relating to the ARF is likely to be accepted. One does not know the reasons for this but one has heard statements that this scheme would create a moral hazard problem in that it would be an invitation to continuing lack of adequate care and diligence in extending loans and advances. The Committee was not unaware of the moral hazard argument but found it difficult to accept. The present level of non-performing assets derives partly and, I would emphasise the word 'partly', from the earlier policy framework which forced banks to lend to certain sectors and to certain parties even against their better judgment. Once operational autonomy is restored — and I will come back to this point later — one could legitimately expect this type of lending would not take place. Apart from that, the Committee had clearly indicated that this should be regarded as a one shot operation, not to be repeated, as in the

future, bank managements would have to make adequate provisioning for non-performing assets. Nor am I impressed with the argument that it would cause estimational problems. An independent set of auditors could, as the Committee suggested, look into the non-performing portfolio and fix the appropriate discounts. The other argument against the ARF proposal is perhaps that the amounts would be large. This argument also cannot really be sustained. In the absence of taking such steps like the ARF, bad and doubtful debts would remain in the banks' books and continue to affect seriously their profitability in view of the new provisioning norms and would make the possibility of their accessing the capital market for further capital extremely difficult. I would, therefore, urge that the authorities re-examine the issue and come up with, if not the ARF, as suggested by the Committee, a viable alternative which would remove the overhang of past bad and doubtful debts and enable the banks to write if not on a clean at least a freshly wiped slate.

It has also been reported that the Government is averse to accepting the recommendations of the Committee relating to priority sector lending in terms of redefining the concept and limiting its coverage to 10 per cent of aggregate credit. I believe I should clear one misconception here. There is a feeling that the Committee had argued against lending to agriculture and small scale industry. This is just not correct. The Committee recognised that priority sector lending had played its part and took note of the fact that significant segments of agriculture and small industry had grown to a point where they could stand on their own feet

and obtain credit on normal commercial considerations without the crutch of special credit support. At the same time, the Committee wanted that lending to agriculture and small industry should continue to grow and recommended the institution of a preferential refinance scheme to give banks a continuing incentive to expand credit to these sectors. The Committee felt that if any sections of agriculture and small industry still needed this type of special support, it was the small and marginal farmer and the tiny sector in industry and services. What the Committee had in mind was that calling all credit to agriculture and small industry priority sector credit puts pressure on the banks to expand such lending without adequate attention to the quality as indicated by the recoverability of the loans which would have followed if a nexus had been established between credit and productive activity as indeed was the objective of social lending. On the other hand, the performance of the banks as regards social lending came to be judged merely by the quantitative increase in priority sector credit totals and not necessarily by the quality of the loan and viability of the operations financed and which was affecting the operational results of the banks, both in terms of asset quality on the one hand and income and profitability on the other. A mistaken identity had also developed over the years between priority sector credit and subsidised credit. It is the availability rather than its cost that is the more important constraint with regard to credit to agriculture and small industry. Subsidisation of credit is an aspect of subsidisation of capital which a capital scarce country can ill afford. The subsidisation of credit to the so called priority sector often beyond what was necessary

only created economic rents for the beneficiaries and along with the low interest earned on directed investments led banks in the interest of enhancing their earning capacity to charge extremely high rates of interest to other productive sectors of the economy and in this way contribute to making ours a high cost economy.

On the subject of interest rates, the Committee distinguished between the structure and the level of interest rates. While the latter may be regarded as an aspect of monetary policy, the structure of rates itself had got complicated through detailed administration of various types of credit and deposit rates. It is in this context that there is the need to move towards market related and later to market determined rates of interest. The interest rate structure of the banks is also marked by high transaction costs. The spread between the weighted average rate for banks' borrowing and lending is high reflecting high costs of establishment and low productivity. A situation where credit interest rates are effectively determined by the wage bill in the banking industry is not conducive to enhancing operational flexibility or efficiency. Nor is the sub-optimal quality of a significant portion of the credit portfolio. With greater deregulation of interest rates the need for prudence and caution will be greater especially in respect of security transactions of banks. It will also be necessary at the same time to build up market institutions and provide for adequate liquidity in the market while discouraging practices obviously speculative in character but in the process of preventing misuse of instruments or practices let us not ban even the legitimate use of such instruments or practices.

As regards the level of interest rates, I am happy that the authorities have decided to lower rates. Levels which were appropriate when inflation was in double digits are no longer so. One cannot have real rates of interest for production and investment of around 10 per cent. The recent measures should be regarded as the beginning of an effort to move interest rates more into line with broader macro aggregates and internationally competitive levels. This leads me to mentioning a couple of aspects of the working of the system which are germane to the discussion. In the emerging situation it is time to re-examine the continuing validity of the quantitative norms — the Tandon and Chore norms — to determine the right amount of working capital credit to industrial borrowers. These may have had some relevance in an earlier period when the need was to introduce a measure of credit discipline but in a competitive market determined environment and operating within the ambit of prudential norms regarding, among other things, concentration ratios and exposure limits, the earlier quantitative norms may have outlived their utility. Another aspect relates to consortium lending by banks which is still in force but which also has perhaps outlived its usefulness. The arguments against consortium lending by the term lending institutions, viz., that it slows down decision-making and takes on the character of a cartel which our Committee mentioned apply to banks as well.

In the short run, high transaction costs limits the extent to which spreads can be compressed but a move towards greater efficiency and productivity which has now become an imperative for the banking industry

should over time help to bring about this needed structural change in interest rates.

Another area where inadequate progress has been made is that relating to the international organisation and methods of operations of banks. A time bound bank wise programme to tighten up internal organisation and procedures and institute efficient internal audit and inspection systems is clearly necessary. Equally, operational methods need to be improved including importantly moving towards greater computerisation with a view to enhancing efficiency and customer service and, enabling early detection of any acts of misfeasance.

An important aspect of financial sector reform is to give greater scope for the private sector in banking activity. The discrimination in the matter of certain types of business against banks in the private sector is happily being put an end to. Of greater significance is the willingness now to allow private banks to be set up. This, you would recall, was an important recommendation of our Committee. However, it is time we looked also at the provisions relating to the operations of private banks. I refer as one important example to a section in the Banking Regulation Act which limits voting rights to one per cent irrespective of the quantum of shareholding. If we are really interested in more private banks being set up we need to reconsider the need for such a restrictive provision, especially in the context of the institution of a system of prudential norms and safeguards with efficient internal systems of internal audit, and an alert supervisory board. Banking should not only be profitable but seen to be so to evoke investor interest in equity holding. Similarly, the provisions

regarding cross directorships and the requirement that directors should represent special interests and insisting on the Chairman of the bank also being its Chief Executive need to be reviewed. Regulations of the type mentioned were introduced during the phase of social control and have outlived their relevance and, to my mind, are now an anachronism. There has also been strident criticism of the foreign banks operating in India in view of the involvement of some of them in the scam. Certainly if any particular bank has violated the laws of the land appropriate action would need to be taken. Of the large number of foreign banks operating in India, let us remind ourselves, only a few of them have been reported as having indulged in irregular and possibly illegal practices and that several Indian banks and institutions were also involved. To tar all the foreign banks with the same brush because of the operations of a few of them seems to me to be neither rational nor even responsible and could send out wrong signals regarding our attitude to foreign investment.

Perhaps the most important set of recommendations of the Committee on the Financial System dealt with the need for operational flexibility and internal autonomy in the banks and financial institutions. A measure of removing the heavy hand of administration of the system and making it work within the ambit of transparent, consistent and rule-based as distinct from discretionary — and what some felt was — even discriminatory, regulation is clearly needed. If the controlling authorities, be it the Reserve Bank or Government, were to get involved as they have been in details of internal administration it would have, as indeed it has, the effect

of demotivating bank managements from taking decisions on matters which should properly fall within their domain. It is entirely appropriate for the authorities to lay down macro policy guidance for credit but when this degenerates to interference in macro credit decisions, it lends itself to political or administrative abuse and tends to erode functional autonomy, weaken the self-confidence of bank managements and absolves them from accountability for their actions. Lending to sick industries is a case in point. Rehabilitation finance packages are often forced on the banks and financial institutions against their better commercial judgment. Apart from the larger economic loss in financing units the judgment on whose potential viability represents a triumph of hope over experience, this type of behest lending has affected banks' profitability and management morale.

For autonomy to be truly meaningful and to institute a greater degree of professionalism in the industry it is essential, as our Committee pointed out, to review the present system of appointments of chief executives and the boards of banks and financial institutions. There is, as I said on an earlier occasion, a perception rightly or otherwise that appointments to these senior positions have deviated from strict standards of professionalism and are rewards either for services rendered or favours expected. There is need for a qualitatively different type of leadership in the financial system. Depoliticalisation of the financial system is an essential aspect of financial sector reform. I would once again commend the Committee's suggestion that in place of the present system of appointments we should evolve a system whereby chief executives and boards would be chosen

by an independent panel whose recommendations should be accepted. One sees little movement in this direction.

The recent happenings have also raised the question of the effectiveness of supervision over the banking and financial system. The Committee's emphasis, consistent with its philosophy of providing for greater autonomy and operational flexibility to the institutions was on self-regulation with the main responsibility for ensuring compliance with prudential norms and requirements being with the banks and institutions themselves and ensuring strict compliance of these requirements through periodical returns and by the supervising authority satisfying itself that the internal systems are in place which would ensure timely and accurate returns. This way accountability and autonomy could be combined. The recent events have not, to my mind, altered this prescription.

On the issue of the appropriate authority of supervision it would have been preferable to have had a separate agency under the aegis of the Reserve Bank of India rather than as now and indeed as appears to be envisaged a department of the RBI to be entrusted with this task so that the Reserve Bank could appropriately concentrate on its primary and traditional function of monetary and exchange management.

Financial sector reform would not be complete without restoring to the Reserve Bank its rightful pre-eminence and giving it full operational autonomy and control over the financial system. The present dyarchy of control over the system between Government and the Reserve Bank should end and the Reserve Bank made primarily

responsible for overseeing the operations of the system. The law enjoins on and the public expects of the Reserve Bank that it would perform its role as the guardian of monetary and exchange stability in a professional manner and even though one may not go so far as to call for a totally independent central bank we ought to have a much greater measure of autonomy "within the Government" as the saying goes.

There are thus several areas where financial sector reform is yet to be implemented. The unfinished agenda is a long one. If the various sets of integrated measures proposed as part of financial sector reform both on the side of funds deployment and organsiational and operational system are not implemented in a phased (but not lengthy) manner the profitability and even survivability of banks would continue to be under pressure. Reform and structural adjustment cannot be altogether painless. It is not for the faint hearted. It is well to recognise that in the short run some aspects of reform would hurt those now obtaining privileges. Yet the longer term needs of competitive efficiency of the system for the larger good may dictate affecting the entrenched interests of some. Creating a political constituency for reform is important and no less so in respect of the financial sector.

Time does not permit me to go into the aspects of reform in other parts of the financial system such as the non-banking financial intermediaries, capital markets and insurance. As regards the non-banking financial intermediaries, the A. C. Shah Committee recently reported on this sector and I would hope that its recommendations receive earnest consideration. As

regards the capital market I would merely content myself here by saying that we need to press on with our effort at instituting proper systems and procedures in both the primary and secondary markets aimed at enlarging the range of investor choice and ensuring investor protection. For the capital market to function in an orderly way, it would be for SEBI to lay down a set of prudential norms; and regulations while permitting the stock and capital markets a measure of autonomy and encouraging self-regulation. I am also happy that the structure of our insurance industry is also under review and would express the hope that the result of that review would enable this important sector of financial services to be made more competitive and efficient through an injection of private initiative.

Nothing has happened in the last couple of years that has brought into question either the rationale or scheme of reform. Inadequate financial sector reform would affect progress in other aspects of structural reform. At the same time, proper sequencing of the reform process is vital; the end of financial repression should not, as I keep saying, herald the advent of financial anarchy. Financial liberalisation would be successful only in an atmosphere of broad macro economic stability. Financial sector reform is an inalienable part of total structural reform, aimed at creating a vibrant and competitive economy.

Our cherished objectives of growth and social justice are not indeed incompatible. Growth is the sure foundation for even distributive justice and the efforts of the State to push the latter objective have to be not through pervasive controls that inhibit growth but by becoming

directly responsible for expanding the social infrastructure especially in areas like education, health and employment generation. Such a role for the State in turn while furthering the cause of social justice would also help the growth process itself. Growth and social justice in this sense are mutually supportive and a source of strength to our democratic polity.

I cannot do better than concluding by reading a paragraph from an address by Mr Shroff way back in 1959 and I quote: "My humble appeal to all my countrymen is to realise what glorious future lies before us if only we could cling passionately to democratic values, allow the fullest scope to individual initiative and enterprise, recognise the diginity and worth of the individual and place trust in him... and thus bring about through democracy and free enterprise within socially desirable State regulations an era of plenty, prosperity, freedom and social justice."

The A. D. Shroff Memorial Trust has no specific views on these economic problems. This publication is issued for public education, and hence the views expressed are specifically those of the author.

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