Financial Exclusion in India

The Role of World Bank

Financial Sector Reforms in India

De-regulation and unification of the interest rate structure along with reduced flows of priority credit to deserving borrowers,

- Marketised borrowing by government end to deficit finance increased debt liabilities which sqeeze public expenditure under social heads.
- Credit-risk adjusted lending by commercial banks to conform to the **Basel I and II norms** relating to capital adequacy.Reduced flow of credit to poor and the SMEs.

Basel Norms Defined

- Basel I introduced Capital Adjusted Ratios for banks with 8% equities held against other assets
- Basel II introduces Credit Risk Adjusted Ratios (CRAR) with larger banks allowed to use their own risk assessment models to determine the risk contents of their assets.
- 3 pillars of Basel II include Capital adequacy requirement, risk based supervision, and market disclosures.
- Banks able to reduce the non performing asset (NPA) ratios.

Financial exclusion

- Sharp decline in credit share of SMEs and poor.Share of bank credit from Public Sector Banks to small sector and SMEs fell from 17% (1999-2000) to 10% (2003-04. From private banks it fell from 20.6% to 7.1%.
- Preference for consumer credit (e g housing loans) over other forms of priority credit. Also flow of credit to credit cards.
- Preference for risk free government securities

Financial sector reforms in India (contd)

- Easier access to foreign capital including portfolio finance with the FIIs bringing unprecedented boom, profitability and instability in the secondary market for stocks with related volatility.
- Corporate governance geared to stock markets and less for real expansion, e.g, with investments in financial securities and with stock options
- Introduction of current account convertibility in 1993 and a gradual switch-over to the full convertibility of the rupee. It makes the rupee rate as well as stock prices subject to speculatory flows of capital in the market .

On World Bank Initiatives: SAP

Policy measures connected with SAP based on the Anderson memorandum titled "trade reforms in India" dated Nov. 30, 1990 submitted to government of India by the world bank.

- Devaluation of rupee
- New industrial policy to allow more foreign investments.
- Opening up areas for private domestic and foreign investment.
- Privatisation and disinvestment of government equity in profitable public sector enterprises.
- Sick public sector units closed down.
- Reforms of the financial sector
- Liberal import and export policy.
- Cuts in fiscal deficit and social spending.
- Market-friendly approach .
- Liberalization of the banking system.
- Tax reforms leading to greater share of indirect taxes.

On World Bank Initiatives: SAP (contd)

- Under SAP, WB now monitors the entire macro-economy such as balance of payments, fiscal deficit, public expenditure reviews as part of the Bank's conditionalities. Under this review, the Bank not only asks for cuts in expenditure but also gives detailed instructions for cuts in specific sectors. The health budgets in recent years are an example of this.
- Other measures include liberalizing Interest Rates, Competitive Exchange Rates, Trade Liberalization, Liberalizatoin of Inward foreign Direct Investment

World Bank: Other initatives (contd)-ROSC

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)

- ROSCs provide an opportunity for countries to evaluate the strength of their insolvency and creditor rights systems in the context of their legal and institutional frameworks, rights and opportunities for alternatives to liquidation
- *Corporate governance norms* follow the OECD principles of corporate governance and based on a template developed by the World Bank.In India diagnostic on basis of the completed template prepared by the Confederation of Indian Industries..
- World Bank and the IMF have prepared *Guidelines for Public Debt Management*

WB : Other Initiatives(contd) - FASF

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- International Monetary Fund and the World Bank have run a program called the *Financial Sector Assessment Program (FSAP)* that helps countries identify with WB leadership vulnerabilities in their financial systems and determine needed reforms with WB leadership. Assess the implementation of standards and codes in the context of the joint IMF-World Bank initiative.
- Assessments of accounting & auditing, corporate governance, and insolvency & creditor rights regimes
- This system of international benchmarks developed jointly with the International Monetary Fund helps countries recognize vulnerabilities in their financial systems and determine appropriate reforms and benchmark their systems against international practices.

WB: Other Initiatives- Basel codes; BAM

- Supervisory Frameworks and Practices - The World Bank conducts assessments of various aspects of risk-based supervisory frameworks and supervisory practices over the financial sector in developing countries and in countries which decided to implement CRAR under Basel II.
- Bank Assessment Model (BAM) - This tool advocates the use of financial simulation as part of systemic surveillance and follow up activities. The World Bank assists countries in adopting BAM in order to address the challenges of building sound and efficient banking systems

CONCLUSION

- World Bank has a major role in the financial engineering in India which is responsible for large degrees of financial exclusion for those who are productive as well as creditworthy.
- This has come through SAP related strictures affecting social sector spending, privatisation of public sector undertakings, removal of subsidies, on as well as financial sector surveillance including constraints on bank advances, freeing of interest rates, free flow of capital and related boom with volatility in stock markets, credit constraint related to rise in reserves etc
- In effect the country has lost autonomy as well as national sovereignty in directing economic policy to a direction which is both production oriented as well as egalitarian.