U N C T A D, Geneva

Intergovernmental Group of Experts on Financing for Development

9th Nov. 2017

DEVELOPMENT BANKING IN INDIA: REMINISCENCES AND PROSPECTS

Y V Reddy

The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.

OUTLINE

I. Multiple Perspectives

II. Review of Experience

III. Lessons

IV. Current Global Context

V. Opportunities and Challenges

I. Multiple Perspectives of a Participant

1. Negotiating loans for Development Banks (DB) with Government of India (IDBI, ICICI, NABARD, etc.) / World Bank – 1970s
2. Encouraging World Bank loans to DBs: Indian experts to World Bank (1980s);
3. CEO of DB at State level and dealing with World Bank and IDBI (1987-88);
4. On the Boards of most DBs at national level and Secretary to Government of India (early 1990-96);
5. Central Banker in-charge of Development Finance reform also (1996-2002) and (2003-2008);
6. Opposed Larry Summer's proposal in Singapore Fund Bank Meeting for World Bank intermediation of South forex reserves;
7. No job but work on development issues (2008 –

Note: Most DBs in India were part of central banking, later transferred to Government and then partly privatised. World Bank supported both public and private DBs. World Bank was opposed by left for spreading capitalism and also by the right for supporting Government ownership.

II. Review of Experience

1. DBs were designed at a time when private sector was not developed; financial sector was not developed; and we were in a planned economy.

2. DBs with their expertise helped develop financial market infrastructure institutions and thus supported the reform. They made profits.

3. Withdrawal of monopoly, license, control, import restrictions, tax concessions etc. by Government and of concessional refinance by RBI resulted in losses. Whenever risk rested with DBs, there were losses in their balance sheets, unless shifted to other balance sheets (refinancing , debt and equity portfolios).

4. Conflict of interest with borrowers on the Board, and DBs being both debt and liquidity holder.

5. DBs wanted subsidy or other monopoly elements in order to survive and serve the economy.

6. Government confined subsidy to some (agriculture and small industries). They are financially sound but not their clientale who bear the risk.

7. Simultaneously, new DBs created, viz., IDFC (recently converted into a bank) and IIFCL – for infrastructure. (The latter refinances).

8. Recent large NPAs of banks to some extent due to infrastructure financing brought the option of DBs on the table.

Note: Assessment of costs and benefits of DBs is proving to be difficult so far.

III. Lessons

1. DBs are useful depending on relative capacities of private sector, financial sector, and state / government sector.

2. DBs require fiscal support, regulatory forbearance and sometimes special access to natural resources or monopoly. Sometimes they may be justifiable.

3. Benefit of better coordination is possible in DBs, but downside is conflict of interests.

4. Costs, benefits, leverage and where risk lies are not transparent. In DBs.

5. In DBs dealings with multi-national bodies, costs and conditionalities are not clear.

6. In DBs, risks are usually concentrated.

7. For policy purpose, DB is good if it is well designed and appropriate to circumstances of the country.

IV. Current Global Context

1. Official financial flows from traditional sources are diminishing and the new sources, both bilateral and regional new institutions are emerging. Private financial flows also are uncertain because of conditions in advanced economies.

2. World Bank work is now supplemented by several multiple formations – official and private.

3. All countries in the world are trying to restore policy space for public authorities from globalization. They are also rebalancing in favour of state / government vis-a-vis markets.

4. Even central banks including China are hedging risks associated with foreign assets by buying Gold instead of investing in foreign currency, or more important, investing them in physical assets such as ports or roads.

5. New world of cross-country projects has unfamiliar risks-reward sharing, cost-benefits and resolution mechanisms.

6. Blurring of distinction between North and South, between giver and taker of liquidity.

7. Are we entering a new bipolar world? Earlier, bipolar worlds (USSR and USA) were distinct and the world was divided between communist and capitalist systems without much inter-dependence. Now, China and USA are competing but they are very inter-dependent. This has unknown implications for the rest of the world.

V. OPPORTUNITIES AND CHALLENGES

1. Development Banks provide good opportunity to have a contextual mix of state and market, financial and real, global and national.

2. Development Banks have institutional flexibility to combine official and private, domestic and international finance.

3. In the new approach to Development Banking there is diversity of shareholders, multiplicity of interests and a variety of instruments, but all risks are with the government.

4. Development Banks succeed only with fiscal support, either direct or implicit guarantee and have unlimited liability on the governments.

5. The capacity of governments in countries to bear risks vary significantly. All risks rest with the sovereign. Each country has to assess its capacity to bear risks and consequences of the size and functioning of Developmental Banking.

6. Benefits of coordination through development banking must be commensurate with the risks of conflict of interests if checks and balances are not in the open.

Conclusion:
There is a case for expanded role for development banking provided it is redesigned keeping in view a) the lessons of the past; b) the new emerging realities in the global arena and c) the context of the countries concerned.