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Mission statement for finance

India urgently needs foreign capital and foreign institutions to build up its own national, rupee-based capital market

The financial crisis gave the US and UK an opportunity to take the lead in cutting banks to size and redefining the role of the financial system in the world economy. The opportunity was wasted. There will be no bold division between utility banking and wholesale markets, no logical step from the premise that regulating complex financial dealings is almost impossible to the conclusion that such dealings should be insulated from the provision of credit and payments. We are heading back to business as usual, albeit with higher capital requirements, more nervous and interventionist regulators and some useful patches on ragged areas of supervision in the US and Europe.

The chaos and humiliation of the financial crash in the 'Anglo-Saxon' economies has given way to a frustrating and confused debate about how to make sure it does not happen again. Y.V. Reddy noted, in his recent book while RBI governor, that "there is some merit in viewing the crisis as a significant intellectual failure," a "moral and intellectual failure in both the private and public sectors". One way of describing this failure is that political and financial leaders were unable or unwilling, as Alan Greenspan confessed, to develop a simple, convincing explanation of what was going or could go wrong. There is now a similar lapse in outlining a convincing remedy in terms that ordinary people, many of them furious about the damage caused by the crisis, can understand.

This has played out in the UK as a fight between Gordon Brown's government and the Bank of England. The bank now distrusts the wholesale financial markets based in London, and wants more powers to intervene against threats to stability. The treasury, whose white paper on future regulation has just been published, wants to balance new regulation with maintaining the UK's earnings from financial services. It also has the task of defending the PM from the charge that he encouraged light touch regulation as the UK lived beyond its means on taxes levied on short-lived banking 'profits'. Meanwhile, the British public has almost given up trying to make sense of the connection between huge fiscal outlays for bank rescues, bonuses for heads of nationalised banks, lobbyists reviving the slogan about London as a financial centre, and re-regulation.

This need to articulate a clearer view of the appropriate role of the financial system in the domestic economy is not just confined to countries cleaning up after the crash. It also applies to China, India and other major economies that have an important part to play in preventing a repetition of the unbalanced pattern of global growth that underlay the crisis.

In India, the popular perception that the RBI's conservatism insulated the country from crisis-prone financial globalisation is right, but it obscures two crucial points: the fundamental soundness of financial policy, and the need for radical measures to keep it moving in the same direction. Calls for loosening external commercial borrowing have often been ignored, as have the calls for liberalisation to create 'financial centres.' Dozens of crises have shown that if globalisation means open access to debt financing or unregulated freedom to create big liabilities in somebody else's currency, then it's a disaster, if guaranteed by the government. And even if not guaranteed by government, the most sophisticated corporate treasures have been found wanting in dealing with complex currency or interest derivatives involving multi-currencies.

But far from endorsing conservative policies, the implications of the crisis, for India are radical. If the enormous capital inflows needed for India's development are to come in as equity, then every obstacle needs to be swept away. Curbs on FDI, standards of corporate governance and auditing – these are all now the focus of a sound long-term financial policy.

So too is the development of domestic debt markets. The development of institutions, natural buyers of long-term rupee debt, needs to be speeded up, with the help of capital inflows from overseas. This year's Economic Survey suggests some of the ingredients – a phased increase in FDI limits in banks, greater entry of foreign banks (funding themselves in rupees), more freedom for insurance and pension funds to buy debt instruments.

India urgently needs foreign capital and foreign institutions to build up its own national, rupee-based capital market, insulated from the worst dangers of financial globalisation. That's the sort of mission statement that the dazed victims of the crisis in the UK and US could understand. ♦