Financial Sector Reforms and Resource Allocation in the Indian economy (1990-2007)
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Abstract

Financial liberalisation in most countries has been based on the logic of improving the efficiency in the allocation of financial resources. The financial sector reforms in India have also been based on same rationale. The argument for liberalising the financial sector on grounds of 'allocative efficiency' has been intuitively appealing because the link between the financial and the real sectors in an economy gets manifest through the allocative role of financial intermediaries and markets.

The financial sector reforms in India have directly targeted financial intermediaries and capital markets. It has also impinged on the financing constraints of the users of finance, in particular, the corporate sector. The change in the allocation of resources during the reform process has thus been the combined outcome of the responses of the financial intermediaries on the one hand, and the users of finance on the other.

This study is based on the premise that the process of allocation of resources in an economy resulting from changes in both the real and the financial sectors needs to be analyzed and understood in its own right before the issue of improvement in efficiency in the allocation of resources can be addressed. The objective of the study is to understand the pattern of resource allocation consequent to the financial liberalisation initiated in India since 1991. The common thread running through the study is the analysis of the changes in the allocation of resources by the credit sector (banks and non-banking finance companies) from the supply side, and by the corporate and the rural sectors in terms of use of finances.

In particular, the study analyses the manner in which the reforms of the credit sector altered the pattern of lending by financial intermediaries such as banks, development financial institutions and private non-bank finance companies. In order to understand the allocative implications of the sectoral shifts in resources over the reform period, the study examines the response of the private corporate sector in the use of financial resources over the liberalization period and also the role of firm specific factors in determining external financing, especially borrowing. The study pays particular attention to spelling out the initial and the changes in the conditions that characterized both the supply and the demand side of credit. The study also analyses the manner in which the reforms impacted the flow of credit to the rural and agriculture sectors. Through the study, the effort is to juxtapose and integrate the changes on the financial and real sectors so as to throw light on the central issue of the thesis i.e. 'resource allocation in a liberalising economy'.

The study finds that the financial liberalisation has indeed resulted in a change in the allocation of resources in India in terms of sectors, borrower categories and across the interest rate spectrum. It has also improved the efficiency of the banking and the corporate sectors. At the same time, the change in resource allocation has also resulted in imbalances in the economy that has left several sectors, particularly the rural sector underserved.

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