

# Money Shortage

## Financial Services: More capital is needed, but reform is slow.

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Nov. 25, 2005 issue - American Treasury Secretary John Snow was in New Delhi two weeks ago, calling for India to speed up the liberalization of its financial-services sector. He argued that looser rules for foreign investment in banks, insurance companies and pension funds would hasten India's economic rise, "add capital to the banking system, spread credit availability, bring in additional managerial expertise and [enhance] technology."

According to a report by McKinsey & Co., India's financial system is an often-overlooked reason the nation's economic growth hasn't matched China's. India has \$1.1 trillion in financial assets—one fifth of China's. The country's financial depth, a measure that compares the total financial stock in the economy to GDP, is 175 percent, compared with China's 311 percent. Although India's banks have fewer nonperforming loans and have achieved a higher return on their assets than their Chinese counterparts, the report notes, "The bottom line is that India has a lot less money circulating in the financial system than one would expect, given the size of its economy." Unless the country loosens up, it will never be able to match its Asian rival as an FDI destination.

Prime Minister Manmohan Singh understands the stakes. He's been trying to eliminate a 10 percent cap on foreign shareholders' voting rights in private banks. He has also been seeking to raise the limit on FDI in the insurance industry from 26 percent to 49 percent—but as with other reforms, Singh's leftist political allies have stymied efforts to get new investment rules implemented.

Right now, foreign banks can open branches and wholly-owned subsidiaries, and can also acquire up to 74 percent of a domestic bank. But because their voting rights on domestic acquisitions are limited, they have little management control. Still, Citibank, Standard Chartered and HSBC are opening branches and selling credit cards. On the insurance side, global players like U.S.-based MetLife, Prudential and AIG and Germany's Allianz are selling policies and pension plans. Company officials say that pension funds can be an important source of financing for the infrastructure that India desperately needs.

In both sectors, foreign players are counting on rising demand to chip away at resistance in New Delhi. As Subir Gokarn, chief economist for the ratings agency Crisil, notes, India needs new insurance and pension products "to make it easier for people to save and give them security in old age." And the government stands to gain, too, because a liberalized financial sector will push money into investments that will broaden India's growth. True reforms may be just a matter of time.

—Jason Overdorf

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