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BRIEF

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REFORMING INDIA'S FINANCIAL SYSTEM

ILA PATNAIK AND AJAY SHAH

India's financial system has long been inadequate. With an economy worth $2 trillion, the country's financial flaws are increasingly serious and outright dangerous. But fundamental change is under way. The government-backed Financial Sector Legislative Reforms Commission drafted the Indian Financial Code (IFC), a single unified law that replaces most existing financial law in India and is an important milestone in the development of state capacity. Now the government must work to adopt and implement the full code.

Modernizing Indian Finance

- Existing laws in India are rooted in the notion that the state is benevolent and feature few checks and balances. The draft IFC steps away from this idea of power without accountability.
- Financial law should reflect an understanding of market failures in finance. It should acknowledge that bureaucrats and politicians serve their own interests, not necessarily those of the general public. Objectives for financial regulators and mechanisms governing their functions should be clearly specified, and laws should hold leaders of government agencies accountable for performance.
- The IFC will transform India's financial laws, regulatory architecture, and regulatory functions, providing a modern and consistent framework based on the rule of law, regulatory independence, and accountability.
- The draft code addresses nine areas that require reforms: consumer protection; micro-prudential regulation; resolution mechanisms; systemic risk regulation; capital controls; monetary policy; public debt management; development and redistribution; and contracts, trading, and market abuse.
- The full adoption of the IFC will help build a financial system that allocates resources well, achieves higher growth, and reduces risk.

Preparing for the Law

- The administration that takes power in India following the country's mid-2014 general election should prioritize enacting the IFC. Ideally, parliament will enact the law between 2015 and 2017.
- To pave the way for the law, regulators should voluntarily adopt IFC principles that are consistent with existing laws, such as those related to the rule of law, accountability, regulation-making processes, and consumer protection regulations.
- The government should build up its institutional capacity now to reduce the delay between enacting and fully implementing the IFC. This requires setting up new institutions and changing the way regulators and the government function and interact with firms and consumers. It will necessitate large-scale training of the staff of the regulatory agencies and the Ministry of Finance.

ABOUT THE AUTHORS

Ila Patnaik *is a nonresident senior associate in Carnegie's South Asia Program.*

Ajay Shah *co-leads the Macro/Finance Group at the National Institute of Public Finance and Policy in New Delhi.*

CONTACT

Christopher Dockrey
Government Affairs Manager
+1 202 939-2307
cdockrey@ceip.org

Clara Hogan
Media Manager
+1 202 939-2241
chogan@ceip.org

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