FINANCIAL SECTOR REFORMS IN INDIA: WITH REFERENCE TO HOUSING FINANCE

Dr. Gaurangkumar C. Barot
Assistant Professor (Commerce with Accountancy)
Dr. APJ Abdul Kalam Govt. College, Silvassa
U.T. of Dadra & Nagar Haveli. India. Pin Code-396230
Mob. 09979539493, Email.: gaurangcbarot@gmail.com

ABSTRACT

Indian financial systems means on a regional scale, the financial system is the system that enables lenders and borrowers to exchange funds. The global financial system is basically a broader regional system that encompasses all financial institutions, borrowers and lenders within the global economy. Household sector play vital role in Indian financial system before financial reform phase and after it. This paper contains points like Pre-Reforms Phase, Major Financial Sector Policy Changes in India and the Financial and physical savings of household sector.

Keywords: Household Sector, Financial Reforms, Physical Savings

INTRODUCTION

In India, most of the studies have taken proxy variables like bank branch expansion and total institutional lending to the private sector to represent financial sector liberalization in order to examine their impact on private savings. The research has attempted to examine the Financial and physical savings of household sector during the post liberalization period (as a percentage of GDP) i.e. year 1993-94 to 2012-13 as per availability of secondary data. And on that bases gross financial saving, financial liability, net financial saving and financial saving. It is essential to know the relation between net financial saving and financial saving so on that bases related hypothesis framed and as per suitable test hypothesis tested for better understand the relation.

OBJECTIVES

1. To know household sector on the base of various literature
2. To know the pre-phase and Financial Sector Reforms in India
3. To examine the performance Financial and physical savings of household sector during the post liberalization period

REVIEW LITERATURE

Banerjee, A. et Al, (1993), using an overlapping generation model analyzes the impact of financial liberalization on household savings in the lifecycle framework. Prior to financial liberalization, the young are unable to finance their desired level of consumption in the face of borrowing constraints while they are able to use capital markets to smooth consumption over their middle to old age. Since consumption was lower than desired in the young age, normally the consumption will be higher in their middle and old age. Financial liberalization increases the competition between providers of financial intermediation and it reduces liquidity constraints of consumers. This has a temporary and a permanent effect. The initial temporary effect is the increase in aggregate consumption by the young consumers, which will wane over time.

However, the consumption of old consumers is not immediately affected as they are still affected by their inability to borrow when they were young. The permanent effect of financial liberalization is that as young consumers are no longer credit constrained, they will smooth their consumption. As a result, the saving of a young consumer becomes sensitive to wealth, real income and other demographic and macroeconomic factors.

Reform measures are introduced in a number of different dimensions; privatization of public financial institutions, removal of restrictions to entry into banking, measures aimed at spurring competition in financial markets, reduction of legal reserve requirements, elimination of directed lending, prudential regulation measures, measures aimed at securities markets development and openness of capital account etc along with interest rate liberalization. For analyzing the links between financial sector liberalization and saving, all these dimensions have to be captured. Financial liberalization has theoretically both long-term and short-term effects on saving.

Long term effects include improved saving opportunities including higher deposit interest rates, a wider range of savings media with improved risk-return characteristics, more banks and other financial intermediaries and reduction in liquidity constraints. On the one hand, use of financial instruments offers the household sector wide and indirect access to the yield on the investment opportunities available in the economy (Mc Kinnon , 1973;) On the other hand, reliable access to borrowed funds through the financial system can lower the saving rate as it may result in consumption rather than savings or reduce the level of precautionary saving also, turning some households into dissevers .

PRE-REFORMS PHASE

Among non-banking financial intermediaries, development finance institutions (DFIs) operated in an over-protected environment with most of the funding coming from assured sources at concessional terms. In the insurance sector, there was little competition. The mutual fund industry also suffered from lack of competition and was dominated for long by one institution, viz., the Unit Trust of India. Non-banking financial companies (NBFCs) grew rapidly, but there was no regulation of their asset side. Financial markets were characterized by control over pricing of financial assets, barriers to entry, high transaction costs and restrictions on movement of funds/participants between the market segments. This apart from inhibiting the development of the markets also affected their efficiency.

FINANCIAL SECTOR REFORMS IN INDIA

The Reserve Bank has been consistently working towards setting an enabling regulatory framework with prompt and effective supervision, development of technological and institutional infrastructure, as well as changing the interface with the market participants through a consultative process. Persistent efforts have been made towards adoption of international benchmarks as appropriate to Indian conditions. While certain changes in the legal infrastructure are yet to be effected, the developments so far have brought the Indian financial system closer to global standards. The interest rates offered on Government securities were progressively raised so that the Government borrowing could be carried out at market-related rates. In respect of banks, a major effort was undertaken to simplify the administered structure of interest rates.

Banks now have sufficient flexibility to decide their deposit and lending rate structures and manage their assets and liabilities accordingly. At present, apart from savings account and NRE deposit on the deposit side and export credit and small loans on the lending side, all other interest rates are deregulated. The Indian financial system has undergone structural transformation over the past decade. The financial sector has acquired strength, efficiency and stability by the combined effect of competition, regulatory measures, and policy environment. competition, consolidation and convergence have been recognized as the key drivers of the banking sector in the coming years.

MAJOR FINANCIAL SECTOR POLICY CHANGES IN INDIA

The policies of financial repression began in the India with the bank nationalization episode of 1969 in the second phase. As a result of financial repression policies, the markets were heavily segmented and the underdeveloped nature of secondary markets inhibited competitive pricing of assets credit was inefficiently used by non-price allocation mechanism; bank profitability was negatively affected due to the restrictions on banks' use of funds and the imposition of branch licensing requirements; the restrictions on bank entry and the dominance of public sector banks greatly inhibited competition and efficiency in the banking sector. It was in response to these developments that in middle 1980s the system entered its latest phase of consolidation, diversification and liberalization.

CHANGING ECONOMIC ENVIRONMENT AND PATTERN OF HOUSEHOLD SAVINGS AND INVESTMENT

Pursuant to the process of globalization the economic and financial landscape of India is undergoing a significant transformation. In the process the economy has more diversified with the new sources of growth. In tune with these changes, we have seen the modernization of financial sector that has also increasingly more diversified to meet new requirements of the economy. Equity culture assumes importance in changed financial status of the families, financial literacy can play a major role by equipping consumers with the knowledge required to choose from a myriad of financial products and providers. In India both savings and investment rates are growing but the cause of concern is where they are investing their savings.

Investments in households have increasingly moved either to risk free, government backed, fixed return, low yielding investment or non-financial assets. As per RBI report, only 6 percent of house hold savings was invested in equity, mutual funds and debentures. It is the household sector which occupies a position of dominance over other institutional sectors like private corporate sectors and public sectors in terms of generating savings. This sector is defined to comprise individuals, non government, and non corporate enterprise. The rate of Gross Domestic Savings has proportion of Gross Domestic Product at current market price has increased.

RESEARCH METHODOLOGY

- Area: Financial and physical savings of household sector
- Time of Study: From 1993-1994 to 2012-2013
- Data Sources: Secondary Data Sources is used.
- Tools of Analysis: Statistics tools, Co-relation, Chart etc.

FINANCIAL AND PHYSICAL SAVINGS OF HOUSEHOLD SECTOR DURING THE POST LIBERALIZATION PERIOD

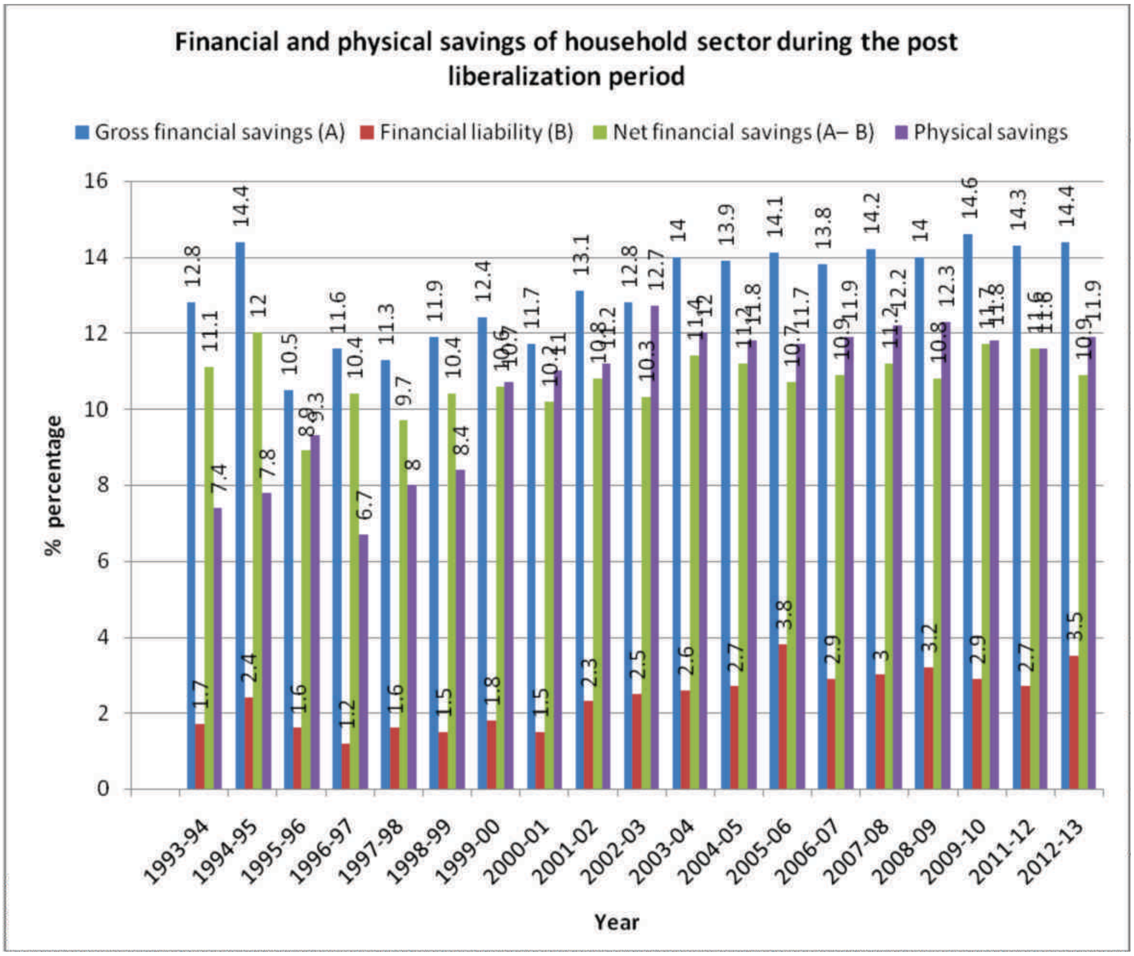
Table No. 1 Financial and physical savings of household sector during the post liberalization period (as a percentage of GDP) - (Figures in %)

Year	Gross Financial savings (A)	Financial Liability (B)	Net Financial savings(A-B)	Physical savings
1993-94	12.8	1.7	11.1	7.4
1994-95	14.4	2.4	12.0	7.8
1995-96	10.5	1.6	8.9	9.3
1996-97	11.6	1.2	10.4	6.7
1997-98	11.3	1.6	9.7	8.0
1998-99	11.9	1.5	10.4	8.4
1999-00	12.4	1.8	10.6	10.7
2000-01	11.7	1.5	10.2	11.0
2001-02	13.1	2.3	10.8	11.2
2002-03	12.8	2.5	10.3	12.7
2003-04	14.0	2.6	11.4	12.0
2004-05	13.9	2.7	11.2	11.8
2005-06	14.1	3.8	10.7	11.7
2006-07	13.8	2.9	10.9	11.9
2007-08	14.2	3.0	11.2	12.2
2008-09	14.0	3.2	10.8	12.3
2009-10	14.6	2.9	11.7	11.8
2011-12	14.3	2.7	11.6	11.6
2012-13	14.4	3.5	10.9	11.9

(Source: Economic Survey, various issues)

From the above table it is evident that the net financial savings were measured over a period at slow phase where as physical savings as consistently out phase in the financial savings. It can be deduced that domestic savings are not opting for financial savings which is more productive and rewarding. At the commencement of liberalization process the proportion of net financial savings are almost 150 percent of physical savings where as at present the financial savings are only 88 percent of physical savings of household sector. On this back ground let us make an analysis of savings pattern of Indian house hold during the post liberalization period to access their performance in various financial assets. The same thing is represented through below chart.

Chart No. 1 : Financial and physical savings of household sector during the post liberalization period (as a percentage of GDP)



Hypotheses Testing

H_0 = There is no Negative Co-relation between Net financial savings and Physical Savings of household sector.

H_1 = There is Negative Co-relation between Net financial savings and Physical Savings of household sector.

Table No. 2. Rank Co–relationship between Net financial savings and Physical Savings of household sector

Net financial savings (A– B) = X and Physical savings=Y

X	Y	Rx	Ry	D (Rx-Ry)	D^2
11.1	7.4	7	18	-11	121
12.0	7.8	1	17	-16	256
8.9	9.3	19	14	5	25
10.4	6.7	15	19	-4	16
9.7	8.0	18	16	2	4
10.4	8.4	14	15	-1	1
10.6	10.7	13	13	0	0
10.2	11.0	17	12	5	25
10.8	11.2	10	11	-1	1
10.3	12.7	16	1	15	225
11.4	12.0	4	4	0	0
11.2	11.8	5	7	-2	4
10.7	11.7	12	9	3	9
10.9	11.9	8	5	3	9
11.2	12.2	6	3	3	9
10.8	12.3	11	2	9	81
11.7	11.8	2	8	-6	36
11.6	11.6	3	10	-7	49
10.9	11.9	9	6	3	9
				0	759

Ed^2 $=759$

Formula of Rank Co-relation **(R)** $= 1 - \dfrac{6Ed^2}{n(n^2-1)}$

$$= 1 - \frac{6 \times 759}{19(19^2-1)} = 1 - \frac{4554}{19(361-1)} = 1 - \frac{4554}{19(360)} = 1 - \frac{4554}{6840}$$

$= 1 – 0.66 = + 0.33$

R= + 0.33 its shows positive relationship between Net financial savings and Physical Savings of Household Sector

RESULT OF HYPOTHESIS TESTING

Hence, here H_0 Hypothesis is accepted, therefore There is no Negative Co-relation between Net financial savings and Physical Savings of Household Sector.

INTERPRETATION

From the Hypothesis test result shows that there is no Negative Co-relation between Net financial savings and Physical Savings of Household Sector. Household sector should maintain and managed this positive relation for smooth operation as it does.

CONCLUSION

The financial system is characterized by the presence of integrated, organized and regulated financial markets, and institutions that meet the short term and long term financial needs of both the household sector. Financial markets and financial institutions play an important role in the financial system by rendering various financial services to the community. They operate in close combination with each other. The way Net financial saving and Physical saving maintained is very important for Indian financial and specially for Household sector.

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