Development Bank for Infrastructure Funding

Why in News

The government is planning to set up a new **Development Finance Institution (DFI)** essentially to fill the gap in long-term finance for infrastructure sectors.

Key Points

- **Proposed DFI:**
  - **It** will be used to finance both social and economic infrastructure projects identified under the National Infrastructure Pipeline **(NIP).**
    - In April 2020, the Government released the **final report on NIP for 2019-25,** which had drawn up projects totalling investments of Rs. 111 lakh crore across roads, railways, energy and urban sectors.
    - The task force on NIP was headed by **Atanu Chakraborty** (economic affairs secretary).
    - NIP will enable a forward outlook on infrastructure projects which will create jobs, improve ease of living, and provide equitable access to infrastructure for all, thereby making growth more inclusive.
- **Role of Government in DFI:**
  - The DFI can have two types of character:
    - Either it should be **promoted by the government.**
    - Or it should be given a **private sector character** with the government restricting its holding to 49%.
  - There are clear **advantages if the DFI is fully held by the government,** the most important being **fund-raising.**
    - The securities from the DFI could be made **Statutory Liquidity Ratio (SLR)** eligible. This will encourage banks to subscribe to the securities issued by DFI and fulfil their SLR obligations.
    - The **Reserve Bank of India (RBI)** requires banks to set aside 18% of their net demand and time liabilities towards SLR.
    - However, the issue involved in this is that the senior management of the DFI may be **hounded by investigative agencies** such as the Central Bureau of Investigation (CBI), and be **subject to the scrutiny** of the Comptroller and Auditor General (CAG) and the Central Vigilance Commission (CVC).
  - A **DFI with a private sector character** will require the government to believe and trust the private sector.
    - This will require the government to maintain some distance from the private sector DFI institution and let it implement and execute projects aimed at improving the quality of life of all citizens.
    - The institution can also work without fear of the CBI, CVC or the CAG.

- **Issues in Infrastructure Funding:**
    - **Funding Gap:** Banks are unable to provide long-term finance to infrastructure projects.
        - Infrastructure financing is currently dominated by bank lending, with **outstanding credit to the infrastructure sector touching 15% until FY16.**
        - However, due to rising **non-performing assets** in the banking sector driven by declining asset quality in the infrastructure sector, the share **has declined to 12% in FY19.**
    - **Asset/Liability Management Mismatch:** In India, most lenders borrow funds with maturity under 5 years. The reason is primarily the absence of a deep bond market to borrow from. As a result, they lend to a project with a maturity of, say 20 years, with funds of 2-year maturity. This leads to a mismatch in the maturities of assets and liabilities for the lender.
        - Asset/liability management is one of the **main tools for evaluating financial risk** and for periodic testing and preparation of financial policies.

Development Finance Institutions

- **DFIs provide long-term credit** for capital-intensive investments spread over a long period and yielding low rates of return, such as urban infrastructure, mining and heavy industry, and irrigation systems.
- DFIs often **lend at low and stable rates of interest** to promote long-term investments with considerable social benefits.
- DFIs are also known as **Development banks.** They are **different from commercial banks** which mobilise short- to medium-term deposits and lend for similar maturities to avoid a maturity mismatch-a potential cause for a bank's liquidity and solvency.

DFIs in India

- Soon after independence, the institutional framework for development banking began- IFCI (1948), IDBI (1964), IIBI (1972), **NABARD** and EXIM Bank (1982), SIDBI (1990), etc.
- However, in the past few years, DFIs such as ICICI, IDBI and IDFC have transformed into universal banks as they **did not have the advantage of low-cost funding for long term projects.**
- Currently, **DFIs are sector-specific,** such as Rural Electrification Corp. Ltd (REC) for the power sector, National Bank for Agriculture and Rural Development (NABARD) for the agriculture sector, and Indian Railway Finance Corp. to fund rail infrastructure among others.

Way Forward

- If India has to grow 8-10% continuously, credit growth for infrastructure must be 12-14%. Since, infrastructure projects require long-term funds, and given the scale of investment required, a large DFI is a good idea.
- Compared with banks, a DFI provides long-term finance for social and economic infrastructure. However, DFIs involve higher risk than what the ordinary financial system may be willing to bear.

Source: IE