



Development Finance Institution

Description

Theme:

- On 1st February 2021, the finance minister of India Nirmala Sitaraman proposed setting up of 'Development Finance Institution' (DFI) with initial paid-up capital of Rs 20,000 crore.
- In March 2021, parliament passed the bill to set up the 'National Bank for Financing Infrastructure and Development' (NBFID). Initially, DFI will be fully owned by the government, and later the government's stake will be reduced to 26%.

What is the Development Finance Institution?

- DFI is an organization that provides finance to infrastructure projects that are helpful for the development of the country. In general, commercial banks do not give loans to development projects because they don't get returns immediately and thereby the loans will become bad loans / Non-Performing Assets (NPA). So, DFI is important to every country and especially developing countries to build adequate infrastructure.
- DFI is also called a 'development bank'.

History of Development Finance Institutions in India:

- This is not the first time India is setting up a development bank. there were a few DFIs before. IFCI (1948), ICICI (1955), IDBI (1964) and state-level development finance institutions (SFCs) were set up to fund infrastructure projects. Government-owned DFIs gave loans to many projects until the early 2000s. Later, as per the recommendations of the Narasimham Committee (1991), DFIs are given the option to convert either as universal banks or as a Non-Banking Finance Corporation (NBFC). That's the reason ICICI and IDBI are commercial banks now. By the year 2005, all the DFIs are closed down.
- After 2005, infrastructure projects had to be financed by commercial banks. But there were several challenges.

Benefits of Development Finance Institution:

- In general, commercial banks do not finance long-term infrastructure projects because of low rates of return in the short term. Moreover, due to the fear of forming NPAs, many banks avoid financing these projects. And even if they are financed, commercial banks are not specialized in assessing the risks of these long-term projects and thereby forming NPAs. So, DFIs are essential to fund the infra projects that are of national importance.
- Lack of infrastructure in India is one of the major constraints for economic growth. So, to fix the infrastructure issue, DFIs are needed.
- Financing development projects can create plenty of jobs and can boost economic recovery.
- By effectively utilizing the funds of DFI, the country can work towards poverty alleviation.
- Many countries such as Japan, Germany, Singapore, Brazil built adequate infrastructure through DFIs.
- DFI can help in bringing private investments to infrastructure projects.

Challenges:

- The previous DFIs were failed due to political influence. Preventing the repetition of the same mistake is a big challenge.
- It is announced that the government's stake will be reduced to 26%. Making sure that private ownership acts like social entrepreneurship instead of focusing on commercial gains is also a challenge.
- DFI bill mentioned that no investigation agency will conduct an enquiry into decision making by officials of the company without the approval of the Managing director or the central government. This may lead to a lack of accountability. One of the main reasons for the failure of the previous DFIs is irresponsibility in giving loans. So, this rule may encourage past mistake.
- Earlier, even when DFIs gave loans for the projects, they were not started due to several issues such as land acquisition issues, local protests against the projects etc. That resulted in bad loans. So, clearing the path before financing the projects is another big challenge.

Conclusion:

Setting up of Development Finance Institution is a good step because it is very important to fix the infrastructure issues in India. But the government must take steps to prevent the repetition of the same mistakes that caused the closure of earlier DFIs. There should be transparency and accountability to make DFI sustainable.

Your Turn...

What are your thoughts on Development finance institution? Express your point of view through the comment section below. And subscribe to our blog to read answers to the trending GD topics.

References:

- [Rediscovering development banks](#)
 - [Financing reindustrialization – bring back development banks.](#)
 - [When financial institutions evolved into banks](#)
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