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INDIA’S NEW DFI HAS A FEW CONDITIONS IN FAVOUR, BUT CHALLENGES TOO

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Industry & Services Sector incl. MSMEs and PSUs

Revisiting the development finance institution structure may give the government muscle to push for its infrastructure aspirations. But the key is not to repeat past mistakes.

Old ideas have a way of coming back. For India, one of them is that of a development finance institution (DFI). The government has cleared the decks to set up a DFI to boost infrastructure financing. The institution will have paid-up capital of 20,000 crore and the Centre would fully own it.

The contours announced late on Tuesday indicate that the new DFI would be similar to the earlier ones. In other words, it is but old wine in a new bottle. The DFI’s target is to lend 5 trillion over three years. The finance minister on Tuesday said the DFI would have tax benefits for 10 years. It is also likely that securities issued by the DFI would be considered on a par with sovereign bonds. After all, the institution is owned by the government. This mostly ensures that it gets access to cheap funds. It would also ensure that in case of accessing offshore funds, a sovereign backing keeps a lid on costs.

Erstwhile DFIs too had policy support that guaranteed cheap funds to them. For instance, DFIs could borrow from multilateral agencies and even directly from the Reserve Bank of India (RBI). They could also access cheap domestic funds because their securities were considered on a par with government bonds. But some of these benefits are not available today.

While some experts have flagged these concerns, they believe that getting funding won’t be a tall task. K.V. Kamath, the former head of ICICI Bank who was instrumental in turning ICICI into the bank it is today, believes that the DFI could get funds easily. “Funding is not going to be a problem given that we have counterparties today who would want to deploy their assets in the long term," he said in a webinar on Wednesday. Kamath believes that bond markets today are deeper than before. Even while accessing offshore funds, if needed, the liquidity glut would ensure that borrowing costs are reasonable.

One challenge is that issues plaguing infrastructure projects are still the same. Delays in government clearances have been the top concern. One of the problems DFIs found themselves in the past was a sharp rise in delinquencies in addition to asset-liability mismatches. Unlike in the past, cash flows of infrastructure projects are more transparent, partly due to adoption of technology. Ergo, defaults can be kept under check.

There is no question that India needs infrastructure financing, and from financiers who can take long-term risk. Banks have proved woefully inadequate in giving money for building roads, ports and other infrastructure. Given the plethora of social infrastructure schemes launched by the government over the past few years, the need to fund these schemes and projects is acute. Revisiting the development finance institution structure may give the government muscle to push for its infrastructure aspirations. But the key is not to repeat past mistakes.

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