

4. Development Financial Institution (DFI)

Prelims: Economics- Infrastructure

Mains: GS-III- Infrastructure: Energy, Ports, Roads, Airports, Railways, etc.

Why in News?

- ▶▶ The government has proposed to set up a Development Financial Institution (DFI) to solve the infrastructure financing needs of the country.

Highlights:

- ▶▶ The establishment of such an institution is considered as a positive step as banks do not have the long-term funds to finance such projects.
- ▶▶ Banks cannot afford to lend for such projects because that would shrink their lending capacity as the funds get locked up in such projects for that time period.
- ▶▶ Reasons for DFIs to Fund Infrastructure:
 - ▶▶ To boost economic growth which would increase capital flows and energise capital markets.
 - ▶▶ To improve long term finances.
 - ▶▶ To provide credit enhancement for infrastructure and housing projects
 - ▶▶ As India does not have a development bank, DFI would fulfil the need for us to have an institutional mechanism.
 - ▶▶ Debt flow towards infrastructure projects would be improved.
 - ▶▶ The RBI had specified in 2017 that specialised banks could cater to the wholesale and long-term financing needs of the growing economy and possibly fill the gap in long-term financing.

Development Finance Institution:

- ▶▶ These are specialized institutions set up primarily to provide development/ Project finance especially in developing countries.
- ▶▶ These DFIs are usually majority-owned by national governments.
- ▶▶ The source of capital of these banks is national or international development funds.
- ▶▶ It ensures their creditworthiness and their ability to provide project finance in a very competitive rate.

- ▶▶ It strikes a balance between commercial operational norms as followed by commercial banks on the one hand, and developmental responsibilities on the other.
- ▶▶ DFIs are not just plain lenders like commercial banks but they act as companions in the development of significant sectors of the economy.

Classification of development Financial Institutions:

- ▶▶ **Sector specific financial institutions:** These financial Institutions focusses on a particular sector to provide project finance. Ex: NHB is solely related to Housing projects, EXIM bank is oriented towards import export operations.
- ▶▶ **Investment Institutions:** These are specialized in providing services designed to facilitate business operations, such as capital expenditure financing and equity offerings, including initial public offerings (IPOs). Ex: LIC, GIC and UTI.

