Development Finance in India

C. P. Chandrasekhar

I. SETTING THE CONTEXT

Till recently India was an exemplary instance of the use of development banking as an instrument of late industrialisation. The turn to and emphasis on development banking in the immediate aftermath of Independence is explained by two features characterising the Indian economy at that point in time: one was the inadequate accumulation of own capital in the hand of indigenous industrialists; and the other was the absence of a market for long term finance (such as bond or active equity markets), which firms could access to part finance capital-intensive industrial investment.

The financial structure at Independence reflected the underdeveloped nature of the economy with unduly low levels of domestic saving and investment. As a result the financial structure was inadequately diversified. In terms of the share of financial assets the Reserve Bank of India dominated, with 47 per cent of the total, followed by the commercial banks as a group with 26 per cent and the Imperial Bank with 8 per cent. The gradual decline of the exchange banks, which were established to finance foreign trade, had brought their share in assets down to 5 per cent. Postal savings, Cooperatives and Insurance Cos accounted for 4 per cent each and pension funds for a mere 2 per cent. Thus, excluding the central bank, banks overwhelmingly dominated the financial structure (Goldsmith 1983).

There are limits to which banks could be called upon to take on the responsibility of financing long-term investments. Banks attract deposits from many small and medium (besides, of course, large) depositors, who have relatively short savings horizons, would prefer to abjure income and capital risk, and expect their savings to be relatively liquid, so that they can be easily drawn as cash. Lending to industrial investors making lumpy investments, on the other hand requires allocating large sums to single borrowers, with the loans being risky and substantially illiquid. Getting banks to be prime lenders for industrial (and infrastructural) investment, therefore, results in significant maturity, liquidity and risk mismatches, limiting the role that banks can play in financing long-term productive investment. Other sources need to be found.

Development Finance Institutions

This resulted in a shortfall in the availability of long term finance in a bank-dominated financial system. This was the gap that the state-created or promoted development-banking infrastructure sought to close. That infrastructure was created over a relatively long period of time and was populated with multiple institutions, often with very different mandates. Funds for the development banks came from multiple sources other than the 'open market': the government's budget, the surpluses of the Reserve Bank of India, and bonds subscribed by other financial institutions. Given the reliance on government sources and the implicit sovereign guarantee that the bonds issued by these institutions carried, the cost of capital was relatively low, facilitating relatively lower cost lending for long-term purposes.

These development finance institutions (DFIs) were very different from banks, and were modelled along the lines of the *Kreditbanken* in Germany during its industrial take-off (Gerschenkron 1962). Unlike the latter, they lent not only for working capital purposes, but to finance long-term investment as well, including to capital-intensive sectors. Having lent long, they are very often willing to lend more in the future. Since such lending often leads to higher than normal debt to equity ratios, development banks to safeguard their resources closely monitor the activities of the firms they lend to, resulting in a special form of "relationship banking". Often this involves nominating directors on the boards of companies who then have an insider's view of the functioning and finances of the companies involved. In case of any signs of errors in decision-making or operational shortcomings, corrective action could be undertaken early.

Given the role taken on by the development banks they could not stop with the mere provision of financial resources. They often needed to provide a fledgling industrial class 'technical assistance' in drawing up project plans, identifying technology, implementing the project and even operating plants. This requires more than just financial expertise, so that development banking institutions built a team of technical and managerial (besides financial) experts, who were involved in the decisions related to lending and therefore to the nature of the investment. This close involvement makes it possible for

these institutions to invest in equity as well, resulting in them adopting the unconventional practice of investment in equity in firms they are exposed to as lenders. This would in other circumstances be considered an inappropriate practice, since it could encourage development banks to continue lending to insolvent institutions since they are investors in the firms concerned and may suffer significant losses due to closure.

Given their potential role as equity investors, development banks provide merchant banking services to firms they lend to, taking firms to market to mobilise equity capital by underwriting equity issues. If the issue is not fully subscribed, the shares would devolve on the underwriter, increasing the equity exposure of the bank. Firms using these services benefit from the reputation of the development bank and from the trust that comes from the belief of individual and small investors that the banks would safeguard their investment by monitoring the firms concerned on their behalf as well.

Thus, development banks lend and invest. They leverage lending to influence investment decisions and monitor the performance of borrowers. They undertake entrepreneurial functions, such as determining the scale of investment, the choice of technology and the markets to be targeted by industry, and extension functions, such as offering technical support. Stated otherwise, they are a component of the financial structure that can ensure that lending leads to productive investment that accelerates growth and makes such lending sustainable.

The Indian experience

India's experiment with development banking began with the establishment of the Industrial Finance Corporation of India (IFCI) in July 1948, and continues to this day, even if in considerably diminished form. There have been three phases in the evolution of development banking. The first began with Independence and extends to 1964 when the Industrial Development Bank of India was established, which was the phase of creation and consolidation of a large infrastructure. As institutions were established the scope of development banking in India increased, but even in 1970-71 disbursements by all financial institutions (including investment institutions such as the Life Insurance Corporation [LIC], Unit Trust of India [UTI] and General Insurance Corporation [GIC]) amounted to just 2.2 per cent of gross capital formation. The second period stretched from 1964 to the middle of the 1990s when the role of the DFIs gained in importance, with the assistance disbursed by them amounting to 10.3 per cent of Gross Capital Formation in 1990-91 and 15.2 per cent in 1993-94. Thirdly, after 1993-94, the importance of development banking declined with the decline being particularly sharp after 2000-01, as liberalisation resulted in the exit of some firms from development banking and in a decline in the resources mobilised by other firms. By 2011-12, assistance disbursed by the DFIs amounted to just 3.2 per cent of Gross Capital Formation.[1]

In the first two of these periods, the nature of the DFIs, their mandate and the way they obtained resources marked them out as entities that were part of a *dirigiste* regime. During those years the Indian government followed a highly interventionist development strategy, with controls on trade and foreign investment, regulation of investment choices and decisions, strong exchange rate management and a large public sector.

It is true that even during this period the World Bank, the Asian Development Bank, the International Financial Corporation and bilateral aid institutions were important providers of finance to India. But they did not approve of India's interventionist strategy and for long the World Bank was even wary of lending to the pubic sector. Thus, India's development finance institutions were also important from the point of view of the ability of the state to pursue its own independent strategy, however inadequate that may subsequently have proved.

However, the institutional changes needed to successfully implement the strategy these interventions sought to advance were never implemented. This was especially true of land reform, the role of which was seen as crucial because productivity increase in agriculture was hampered by land monopoly and predatory absentee landlordism.

Moreover, the desire to "catch up" with the developed countries through an emphasis on factory-based industrialisation meant that there was considerable neglect of agriculture, which was seen as a "bargain sector" that would deliver additional output without much investment, largely based on institutional changes such as land reform and subsequent cooperativisation (which was never implemented) (Chandrasekhar 2011). Further, there was little concern for sustainability and the environment, with

[1] Figures computed from information provided in Tables 13 and 83 of Reserve Bank of India (2013).

large projects (such as big dams, chemical plants, power projects and large scale mining) being pushed through despite their adverse environmental effects, and with little effort to mitigate those effects.

The transformation of Indian finance

The pattern of financing of investment began to change in the 1980s when the availability of foreign finance from the private financial market (as opposed to the bilateral and multilateral development aid network) opened up, largely because of changes in the international financial system. That access was seen as providing an opportunity to pursue a more outward oriented development strategy based on all-round liberalisation and deregulation. The balance of payments crisis of 1991 served as the trigger for that transition. An important component of the resulting "economic reform" was financial liberalisation that provided for a growing role for domestic and foreign firms in the financial sector, and offered all financial institutions greater flexibility in mobilising resources and lending and investing them. It was at this point that these domestic and foreign private institutions resented the ability of the DFIs to obtain concessional finance to fulfil their mandate, and thereby compete with them and keep them out of areas that they were earlier least interested in entering, but were now looking to enter.

The resulting pressure to create a 'level playing field', to which the government succumbed not because that was unavoidable but because of its own commitment to liberalisation reflected in the Narasimham Committee reports of the 1990s (especially Narasimham 1998), triggered the process of transforming leading development financial institutions into commercial banks, starting with the Industrial Credit and Investment Corporation of India (ICICI) in 2002 and the Industrial Bank of India (IDBI) in 2004. Though the period since then is relatively short, India's experience during the heyday of development banking and during its early phase of decline offers much to inform the debate on the role that specialised institutions can play in the development process.

The institutional framework

Over the years India had created a rather elaborate development banking structure. There were a number of development banks established over time, catering to different segments of industry and/or different regions or just adding to the stock of institutions engaged in this activity. The process started immediately after Independence, with the setting up of the Industrial Finance Corporation (IFCI) in July 1948 to undertake long term term-financing for industries.[2] In addition, State Financial Corporations (SFCs) were created under an Act that came into effect from August 1952 to encourage state-level, small and medium-sized industries with industrial credit. In January 1955, the Industrial Credit and Investment Corporation of India (ICICI), the first development finance institution in the private sector, came to be established, with encouragement and support of the World Bank in the form of a long-term foreign exchange loan and backed by a similar loan from the US government financed out of PL 480 counterpart funds.[3] In June 1958, the Refinance Corporation for Industry was set up, which was later taken over by the Industrial Development Bank of India (IDBI). Other specialized financial institutions that were set up included the Agriculture Refinance Corporation (1963), Rural Electrification Corporation Ltd. and HUDCO. Two other major steps in institution building were the setting up of IDBI as an apex term-lending institution and the Unit Trust of India (UTI) as an investment institution, both commencing operations in July 1964 as subsidiaries of the Reserve Bank of India.

That the development banks were special institutions was reflected in the role the central bank had in the development-financing infrastructure. An Industrial Finance Department (IFD) was established in 1957 within the Reserve Bank of India (RBI) and the central bank began administering a credit guarantee scheme for small-scale industries from July 1960. With a view to supporting various term-financing institutions, the RBI set up the National Industrial Credit (Long-Term Operations) Fund from the year 1964-65.

There were new initiatives at the level of the states as well in the 1960s. State governments setup State Industrial Development Corporations (SIDCs) to promote industrial development in their territories. Subsequently, with evidence of growing "sickness" in certain sectors, the Industrial Reconstruction

[2] In 1975 the IFCI set up a Risk Capital Foundation in the form of the IFCI Venture Capital Fund to provide soft loans to first generation and technocrat entrepreneurs. IVCF later managed funds of the Venture Capital Unit Scheme of the Unit Trust of India.

[3] Public Law 480 enacted in 1954 in the US allowed for the use of surplus agricultural produce (especially wheat) from the US as food aid to developing countries through sale at concessional terms including payment in local currency, with the local currency funds being used for US diplomatic and development expenditures in the country concerned.

Corporation of India Ltd (IRCI) was established in 1971, and converted into a statutory corporation titled Industrial Reconstruction Bank of India in 1985, with the specific objective of reviving sick and ailing industrial units. Originally established by an Act of Parliament, it was incorporated under the Companies Act in 1997.

Specialized financial institutions set up after 1974 included NABARD (1981), EXIM Bank, which took over some functions related to export-oriented units from IDBI (1982), Shipping Credit and Investment Company of India (1986) (later merged into ICICI Ltd. in 1997), Power Finance Corporation and Indian Railway Finance Corporation (1986), Indian Renewable Energy Development Agency (1987), Technology Development and Information Company of India, a venture fund later known as IFCI Venture Capital Funds Ltd. and ICICI Venture Funds Management Ltd. (1988), National Housing Bank (1988), the Tourism Finance Corporation of India, set up by IFCI (1989), Small Industries Development Bank of India (SIDBI), with functions relating to the micro, medium and small industries sector taken out of IDBI (1989), North Eastern Development Finance Corporation (NEDFi) (1995) and IDFC (1997).

According to the RBI's *Working Group on DFIs*: "DFIs can be broadly categorised as all-India or state/regional level institutions depending on their geographical coverage of operation. Functionally, all-India institutions can be classified as (i) term-lending institutions (IFCI Ltd., IDBI, IDFC Ltd., IIBI Ltd.) extending long-term finance to different industrial sectors, (ii) refinancing institutions (NABARD, SIDBI, NHB) extending refinance to banking as well as non-banking intermediaries for finance to agriculture, SSIs and housing sectors, (iii) sector-specific / specialised institutions (EXIM Bank, TFCI Ltd., REC Ltd., HUDCO Ltd., IREDA Ltd., PFC Ltd., IRFC Ltd.), and (iv) investment institutions (LIC, UTI, GIC, IFCI Venture Capital Funds Ltd., ICICI Venture Funds Management Co Ltd.). State / regional level institutions are a distinct group and comprise various SFCs, SIDCs and NEDFi Ltd." (RBI 2004: Section 1.4.3).

The average annual assistance provided by the leading development financial institutions rose from Rs. 29 million during 1948-52 to Rs. 137 million during the following five years (1953-57) and Rs. 450 million during 1958-62. This growth then accelerated to take the annual average assistance to Rs.1088 million during 1963-66 and Rs. 1442 million during 1967-71 (Kumar 2013).

But the post-1972 period witnessed a phenomenal rise in financial assistance provided by these institutions (including investment institutions), with the average annual assistance disbursed rising from Rs.2.5 billion during the period from 1971-72 to 1973-74 to Rs.25.8 billion during 1980-81 to 1982-83, Rs.199.65 billion in 1990-91 to 1992-93, Rs.542.28 billion in 2000-01 to 2002-03 and Rs.925.39 billion in 2010-11 to 2012-13 (RBI 2013: Table 83). The figures adjusted for inflation (using the deflator for capital formation in the National Accounts Statistics) are Rs.6.6 billion during the period from 1971-72 to 1973-74 to Rs.16.1 billion during 1980-81 to 1982-83, Rs.41.3 billion in 1990-91 to 1992-93, Rs.83.8 billion in 2000-01 to 2002-03 and Rs.137 billion in 2010-11 to 2012-13. As is clear from Table 1, disbursal of assistance by the All-India institutions rose continually till 2000-01, after which it collapsed, as the DFIs were transformed or closed. Even the small industry-focused financial institutions saw a decline after 2000 for a short period, but registered a robust revival as the SIDBI took on an important role. The other major change was the growing importance of the investment institutions (the LIC, GIC and UTI) in financing development. What needs to be noted, however, is that even these institutions were publicly owned, at least till the collapse of UTI in 1998.

Table 2 provides a picture of the relative roles of different kinds of institutions in development financing since 1970, by which time the development financing institutions had been established and consolidated. In the early 1970s and till the end of the 1980s, the All India Financial Institutions (IDBI, ICICI, and IFCI) dominated disbursals of resources accounting for between two-thirds and almost three-quarters of total disbursals. During this time the specialised institutions set up to support small and medium industries at the state and national levels (SIDBI, the SFCs and the SIDCOs) accounted for between 15 and 30 per cent of disbursals and the investment institutions (LIC, GIC and UTI) saw their share rising from less than 10 to about 20 per cent.

In the second phase stretching from the start of liberalisation to the transformation of the ICICI and IDBI into a commercial banks (2002-2004), the share of the All India IFIs fell from two-thirds to just 30 per cent, that of the small industry financing institutions remained more or less stable and that of the investment institutions rose to pick up the slack. Finally, after 2004, the share of the All India FIs collapses to a low of 1.7 per cent in 2012-13 and that of the small industry financiers and the investment institutions rises to 46 and 52 per cent respectively.

The importance of these institutions is clear from the fact that their investments (disbursals) as a proportion of Net Domestic Capital Formation in India rose from less than 5 per cent in the early 1970s to around 24 per cent in 2000-01.[4] Over 70 per cent of sanctions went to the private sector, and took the form of loans as well of underwriting and direct subscription of shares and debentures. Aggregate disbursals as a ratio of net capital formation in the private sector rose from 24 per cent in 1970-71 to 80 per cent just before the 1991 crisis. The role of some of these organizations, such as the IFCI and the IDBI, was particularly important in promoting capital formation. This provision of long-term industrial finance was indeed a major source of support for investments in the country, and constituted an important way in which the limitations of the financial structure as it evolved under colonialism was sought to be addressed, and finance made a tool of development.

Table 1: Disbursals by Principal DFIs by Category (Rs. Billion)

	All India Fis	Small industry Fis	Special purpose	Venture	Investment Instns	
	IDBI, ICICI, IFCI	SIDBI, SFCs, SIDCs	IIBI, SCICI, TFC	IVCF, ICICI Venture	LIC, GIC, UTI	Total
1970-71	1.04	0.45	0.00	0.00	0.13	1.62
1971-72	1.34	0.54	0.01	0.00	0.07	1.96
1972-73	1.49	0.61	0.04	0.00	0.20	2.34
1973-74	2.12	0.75	0.05	0.00	0.28	3.21
1974-75	2.86	1.06	0.08	0.00	0.62	4.62
1975-76	3.19	1.25	0.05	0.00	0.32	4.82
1976-77	4.64	1.40	0.11	0.00	0.45	6.60
1977-78	5.59	1.52	0.09	0.00	0.59	7.80
1978-79	8.01	1.95	0.13	0.00	0.52	10.61
1979-80	9.80	2.70	0.13	0.01	1.87	14.50
1980-81	15.53	3.73	0.17	0.01	1.61	21.03
1981-82	19.38	5.09	0.28	0.01	2.32	27.09
1982-83	20.73	6.12	0.38	0.01	2.03	29.27
1983-84	25.35	6.72	0.41	0.01	3.65	36.14
1984-85	28.65	7.95	0.55	0.01	5.08	42.24
1985-86	36.84	9.73	0.68	0.02	8.98	56.24
1986-87	44.06	12.17	0.95	0.03	9.39	66.60
1987-88	54.33	13.91	1.62	0.04	11.53	81.43
1988-89	54.65	15.27	2.54	0.08	16.12	88.67
1989-90	76.00	17.02	3.80	0.15	16.52	113.48
1990-91	80.43	37.08	3.60	0.19	28.39	149.68
1991-92	97.25	42.43	4.04	0.26	42.09	186.07
1992-93	117.59	43.98	7.30	0.33	94.00	263.21
1993-94	146.72	49.37	12.74	0.32	78.77	287.92
1994-95	203.90	63.22	19.76	1.11	65.14	353.12
1995-96	223.79	89.51	31.60	0.63	65.01	410.54
1996-97	278.06	88.69	7.32	0.45	71.23	445.76
1997-98	366.27	87.67	13.40	0.38	86.12	553.84
1998-99	385.15	100.86	18.21	0.29	96.47	600.97
1999-00	461.67	105.47	15.51	1.48	127.64	711.78
2000-01	512.98	100.85	17.70	1.93	127.93	761.39
2001-02	379.18	76.69	11.55	7.82	116.49	591.73
2002-03	83.95	94.94	11.87	3.96	79.02	273.73
2003-04	52.65	52.71	22.87	3.61	169.89	301.73

[4] Computed using figures from RBI (2013).

2004-05	62.75	61.88	0.72	0.00	89.72	215.06
2005-06	1.87	91.00	0.88	0.00	117.71	211.46
2006-07	5.50	102.25	1.20	0.00	277.57	386.53
2007-08	22.80	150.99	1.89	0.00	284.61	460.29
2008-09	33.12	283.18	2.76	0.07	623.57	942.70
2009-10	60.45	319.42	2.93	0.27	537.60	920.67
2010-11	84.00	387.96	3.79	1.30	401.42	878.47
2011-12	56.80	418.12	5.63	2.86	519.68	1003.09
2012-13	15.04	406.82	3.43	2.81	466.52	894.62
Source: RBI (2013), Table 83						

Table 2: Shares of Different Categories of Institutions in Development Financing Disbursals

	All India FIs	SIDBI, SFCs, SIDCs	Special purpose	Venture	Investment Institutions	Total
1970-71	64.3	27.6	0.0	0.0	8.2	100.0
1971-72	68.3	27.6	0.6	0.0	3.5	100.0
1972-73	63.9	26.2	1.5	0.0	8.4	100.0
1973-74	66.3	23.5	1.6	0.0	8.6	100.0
1974-75	61.9	23.0	1.7	0.0	13.4	100.0
1975-76	66.3	26.0	1.0	0.0	6.7	100.0
1976-77	70.3	21.3	1.6	0.0	6.8	100.0
1977-78	71.8	19.5	1.2	0.0	7.5	100.0
1978-79	75.5	18.4	1.2	0.0	4.9	100.0
1979-80	67.6	18.6	0.9	0.0	12.9	100.0
1980-81	73.8	17.7	0.8	0.0	7.6	100.0
1981-82	71.6	18.8	1.0	0.0	8.6	100.0
1982-83	70.8	20.9	1.3	0.0	6.9	100.0
1983-84	70.1	18.6	1.1	0.0	10.1	100.0
1984-85	67.8	18.8	1.3	0.0	12.0	100.0
1985-86	65.5	17.3	1.2	0.0	16.0	100.0
1986-87	66.2	18.3	1.4	0.0	14.1	100.0
1987-88	66.7	17.1	2.0	0.0	14.2	100.0
1988-89	61.6	17.2	2.9	0.1	18.2	100.0
1989-90	67.0	15.0	3.3	0.1	14.6	100.0
1990-91	53.7	24.8	2.4	0.1	19.0	100.0
1991-92	52.3	22.8	2.2	0.1	22.6	100.0
1992-93	44.7	16.7	2.8	0.1	35.7	100.0
1993-94	51.0	17.1	4.4	0.1	27.4	100.0
1994-95	57.7	17.9	5.6	0.3	18.4	100.0
1995-96	54.5	21.8	7.7	0.2	15.8	100.0
1996-97	62.4	19.9	1.6	0.1	16.0	100.0
1997-98	66.1	15.8	2.4	0.1	15.5	100.0
1998-99	64.1	16.8	3.0	0.0	16.1	100.0
1999-00	64.9	14.8	2.2	0.2	17.9	100.0
2000-01	67.4	13.2	2.3	0.3	16.8	100.0
2001-02	64.1	13.0	2.0	1.3	19.7	100.0
2002-03	30.7	34.7	4.3	1.4	28.9	100.0
2003-04	17.4	17.5	7.6	1.2	56.3	100.0
2004-05	29.2	28.8	0.3	0.0	41.7	100.0
2005-06	0.9	43.0	0.4	0.0	55.7	100.0
2006-07	1.4	26.5	0.3	0.0	71.8	100.0

2007-08	5.0	32.8	0.4	0.0	61.8	100.0
2008-09	3.5	30.0	0.3	0.0	66.1	100.0
2009-10	6.6	34.7	0.3	0.0	58.4	100.0
2010-11	9.6	44.2	0.4	0.1	45.7	100.0
2011-12	5.7	41.7	0.6	0.3	51.8	100.0
2012-13	1.7	45.5	0.4	0.3	52.1	100.0

Policy banks

India soon realised that development banking of the kind described above was not in itself adequate to deal with all its needs. This is because the financial structure must not only contribute to growth by directing investment to crucial investment projects, but it must render development broad-based by delivering credit to sectors that may otherwise be ignored by the financial sector. A typical example of this, for example, is small peasant farming. Credit to support agricultural operations that are seasonal in delivery of produce and subject to much volatility is crucial. But providing credit in small volumes to dispersed and often remotely located borrowers increases transaction costs substantially. Further, the volatility of production, especially in rain-fed agriculture, often results in costly restructuring or large scale defaults. This implies that the risk premia associated with such lending would also be high.

If these transaction costs and risk premia are to be reflected in interest rates charged on loans, rates could be so high that the loans concerned cannot be used for productive purposes. This implies that returns on lending to sectors such as these would be significantly lower than normal. This would require the state to intervene in one of many ways. It could insist on "social banking" on the part of ordinary banks, set low ceilings on interest rates chargeable to priority sectors and provide a subsidy in the form of interest rate subvention. Or it could require public banks to lend at low interest rates and cross-subsidise such lending with returns on normal commercial operations. This would imply that the returns expected of such banks would be lower than a normal purely "commercial" benchmark. Or it could create specialised development banks, which are provided state funds at extremely low interest rates to carry out these operations.

Most countries have found that it is best to create separate development banks to provide long-term capital at near-commercial rates and "policy banks" to provide credit to special areas such as agriculture or the small scale sector where interest rates have to be subsidized and grace periods have to be longer. This allows different criteria to be applied to the evaluation of the performance of these banks, with profitability a more important consideration in the case of the former.

Thus, in India in the sphere of agricultural credit, apart from setting up two funds in 1955, namely, the National Agricultural Credit (Long-Term Operations) Fund and National Agriculture Credit (Stabilisation) Fund from out of the profits of the RBI to support the cooperative credit structure, the Agriculture Refinance and Development Corporation (ARDC) was set up in 1975. Subsequently the government established the National Bank for Agriculture and Rural Development (NABARD) in 1981 to provide refinance for institutions engaged in lending in rural areas and coordinating their activities. What does appear to have happened is that during the 2000s, while the importance of the All-India DFIs has declined, the government has turned to using the specialised policy banks to direct credit to special interest groups while leaving the role of development finance to the publicly owned investment institutions, the public sector banks (see below) and the private capital market.

II. ASSESSMENT OF KEY INSTITUTIONS AND POLICIES

However, till the onset of liberalisation, the development finance institutions were a key element of India's overall development strategy. When India won Independence from the British, it chose to adopt a development path that was unusual and perhaps unique. Despite the country's low level of per capita income, its geographical vastness, its large population and its social diversity, the government decided to pursue a state-led strategy of development with a central role for development planning, but within a the framework of a mixed economy that gave the private sector an important role, on the one hand, and a quasi-federal parliamentary democracy, on the other. All of these features, especially the last made the Indian development experiment an issue of interest to observers from across the world.

There were two important and even conflicting elements to that strategy. First, since India's capitalist class was still to consolidate itself in full, the state needed to support the development process with its own investments and channel resources to support the investments of the private sector. That is, the

state had to serve as a facilitator and backer of private investment. Second, since development planning had to take into account the societal goals of a spatially and vertically unequal society, the state needed to guide investment in socially desired directions and regulate private capital to ensure it also delivered social benefits rather than merely serving private interest.

This was to be achieved by having an overarching body that was responsible for formulating policy and monitoring implementation. Thus, the Planning Commission in India became a powerful body that not merely drew up five year and perspective plans, but had an important say in the policies adopted and pursued by the different ministries and departments, which it vetted and monitored. Inasmuch as those policies were aimed at influencing the level and allocation of private investment the Planning Commission had an impact on the pattern of private sector development. But the government's role was not only regulatory. In its promotional role it not merely invested to establish the infrastructure and create capacities in sectors that were crucial to development but were characterised by lumpy investments, long gestation lags and low returns, but also provided finance, R&D support and technical assistance to the nascent industrial class. Development financing, delivered through the institutions and framework described earlier was an important component of that institutional support.

An important aspect of the state's intervention was the effort to change the mode of utilisation of the surplus. Besides using physical controls such as licensing and foreign exchange allocation, there were four other means through which the state sought to indirectly influence the allocation of the nation's savings. The first was by pre-empting a significant part of the resources mobilised by the banking system, which other than for the State Bank of India and its subsidiaries was largely private. This it did by specifying a Statutory Liquidity Ratio (SLR), or the proportion of the net demand and time liabilities (or demand deposits and time deposits) of the banking system that had to be invested in gold or "approved securities". The SLR was set at 20 per cent in 1949, 25 per cent in 1964 and rose to a peak of 38.5 per cent in 1990, before declining under the influence of economic reform to 23 per cent in 2012. While this marked a decline in the extent of pre-emption after liberalisation, India still resorts to this policy to a far greater extent than other countries. However, since the 1980s much of the government's borrowing from the banking system supports its revenue or current expenditures rather than spending on capital formation. Since the approved securities consisted largely of government securities and public sector bonds, the government was in essence drafting a share of bank deposits for government designated expenditures and investments.

Second, the government nationalised the insurance companies and used its control over the savings they mobilised to direct resources to priority areas of investment. Third, unable to influence the allocation of resources mobilised and available to the private banking system the government chose to nationalise 14 banks in 1969 and another seven in 1980. Finally, using a part of its budgetary resources and some of the 'profits' of the Reserve Bank of India the state provided the development finance institutions the seed money, which they could then leverage, to undertake the financing activities they were mandated to pursue.

Financing of the DFIs

Table 3: Share of Government and RBI in Total Liabilities of Different DFIs (%)

	1965	1971	1975	1980
IFCI	36.75	40.84	25.20	6.00
ICICI	42.65	20.81	8.75	1.12
IDBI	82.08	80.57	71.75	47.61
IRCI			43.48	49.43
SFCs	14.63	22.09	28.78	37.54

Source: RBI quoted in Kumar (2013)

Given the nature of and the role envisaged for the development finance institutions created prior to 1980, it was to be expected that the government and the RBI would have an important role in providing them resources. In addition, public banks and the LIC and GIC would also play a role. As is clear from Table 3, the former two sources accounted for a significant share of resources mobilised by all the All India Financial Institutions, especially the leading institution IDBI. It shows that the RBI was a major funder of the IDBI. Given its private character and the role envisaged for it, as expected over time the role of the government and the RBI in financing ICICI declined sharply after the mid 1960s.

Access to state funding prior to the reform meant that the development finance institutions were in a position to mobilise resources at interest costs that were much lower than if they had relied on market sources. This also allowed them to lend at rates that were reasonable from the point of view of industry and the infrastructural sectors. That made them the first port of call for finance for Indian business, which did substantially benefit from the financial support provided by the government, in the years before the 1990s. However, it was found that the big business groups were able to garner a disproportionate share of the disbursals made by these institutions, when compared to the share of the former in paid up capital and sales.

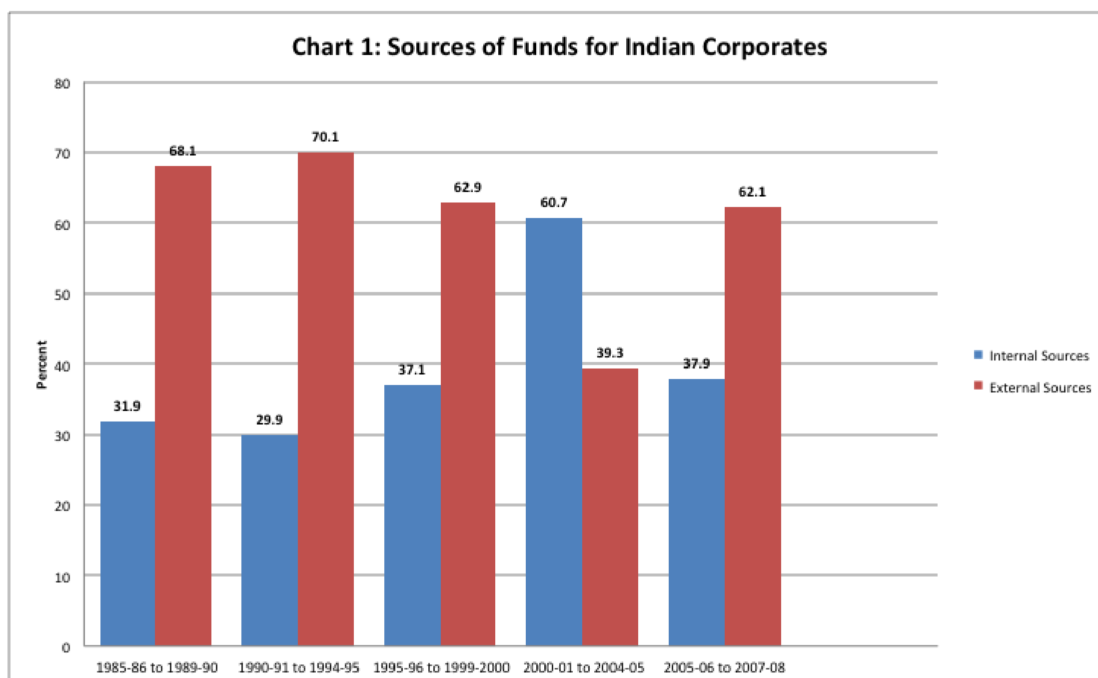
With the government being an important source of finance, it was to be expected that it would exert control over the functioning of these institutions and in determining the leadership of these organisations. This did imply that some political and partisan considerations affected the functioning of the DFIs. It also implied that these institutions were partly protected from close scrutiny by members of parliament and other representatives of the people, since protecting the DFIs was a means of protecting the political executive as well.

What is interesting is that the government did not use this influence to exert control over the firms the DFIs were involved with. The DFIs, by virtue of providing equity and credit to their clients were eligible to have their nominees in the board of director's of the units concerned. However, in most instances in India, DFI nominees were not merely a passive presence on the boards, but tended to support the incumbent management (who were their original clients) in any battle for corporate control. This meant that, even in cases were there was evidence of mismanagement, the proactive and corrective role of the nominees of the DFI was an exception. This was a major failing because it was the DFI nominees who could have a played a role in setting social, environmental and governance standards and overseeing their implementation, since they were public bodies who could ensure that social benefit and good is not always trumped by the interests of private profit.

New sources of finance

The transformation and shrinkage of the development financing architecture after liberalisation raises a question. Since the requirement for long-term, external financing is unlikely to have completely disappeared, where did the new financing come from? One source of financing was an increased role for internal funds. In fact, internal sources such as retained profits and depreciation reserves have accounted for a much higher share of corporate finance during the equity boom of the first half of the 2000s. According to RBI figures (Chart 1), internal sources of finance which accounted for about 30 per cent of total corporate financing during the second half of the 1980s and the first half of the 1990s, rose to 37 per cent during the second half of the 1990s and a record 61 per cent during 2000-01 to 2004-05. Though that figure fell during 2005-06 to 2007-08, it still stood at a relatively high 56 per cent.

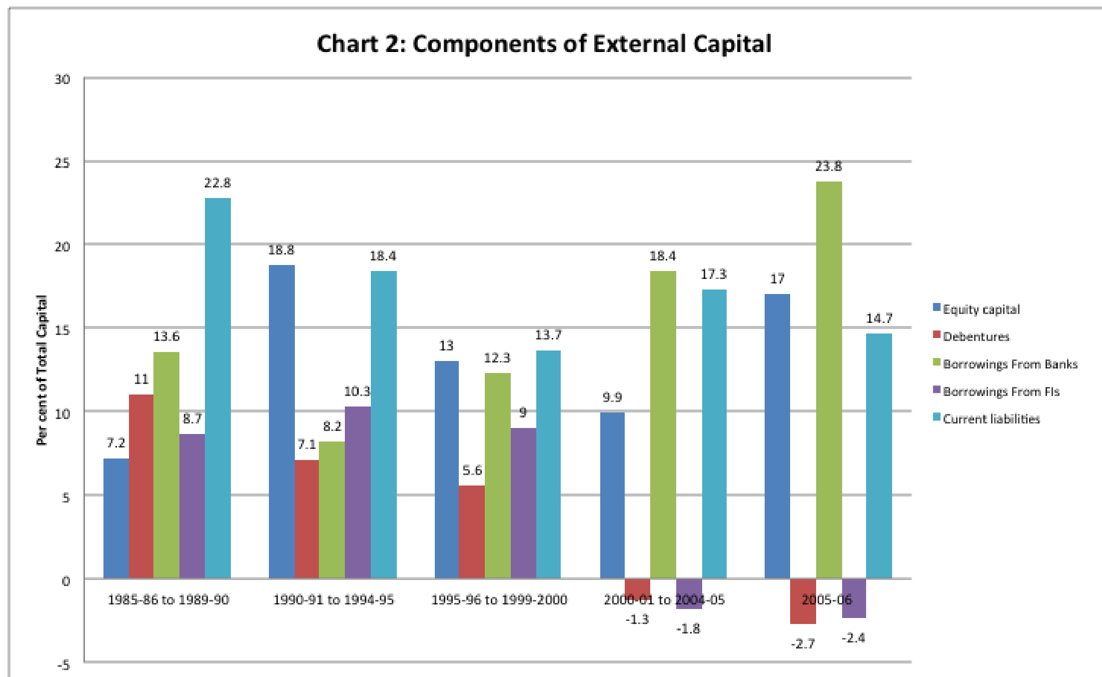
Among the factors explaining the new dominance of internal sources of finance, three are of importance. First, increased corporate surpluses resulting from enhanced sales and a combination of rising productivity and stagnant real wages (Chandrasekhar 2013). Second, a lower interest burden resulting from the sharp decline in nominal interest rates, when compared to the 1980s and early 1990s. And third, reduced tax deductions because of tax concessions and loopholes. These factors have combined to leave more cash in the hands of corporations for expansion and modernization.



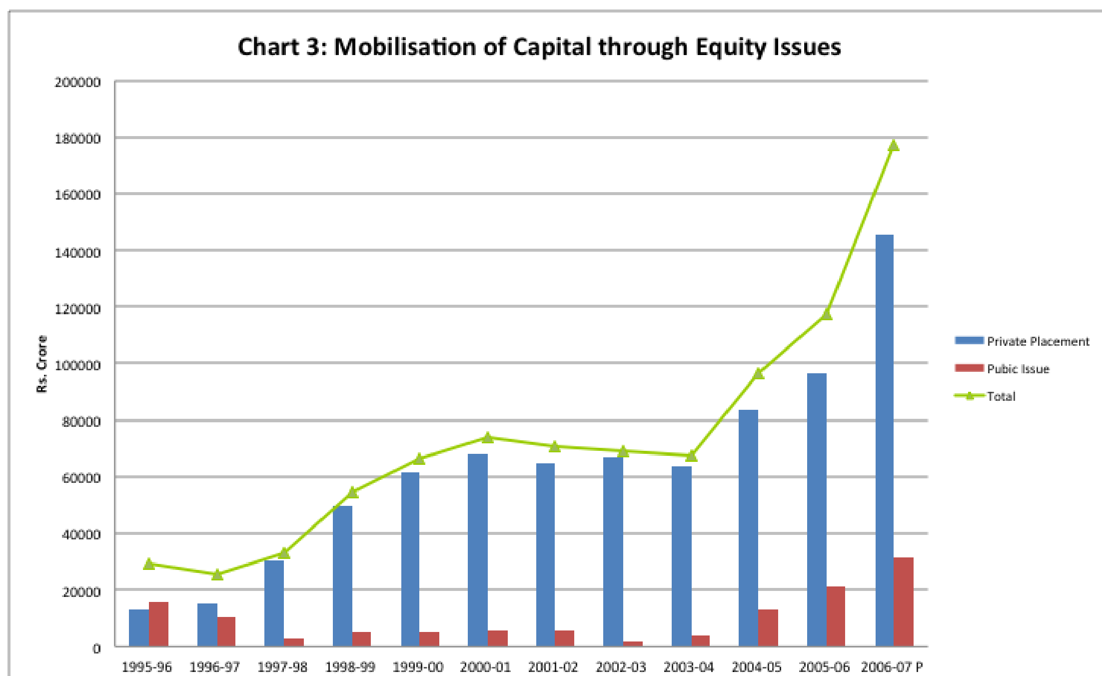
Along with the increased role for internally generated funds in corporate financing in recent years, the share of equity capital mobilised from the capital market in all forms of external or outside finance has also been declining. An examination of the composition of external financing (measured relative to total financing) shows that the share of equity capital in total financing that had risen from 7 to 19 per cent between the second half of the 1980s and the first half of the 1990s, subsequently declined to 13 and 10 per cent respectively during the second half of the 1990s and the first half of the last decade (Chart 2). Further, between 2003-04 and 2006-07, which was a period when FII inflows rose significantly and stock markets were buoyant most of the time, equity capital mobilized by the Indian corporate sector rose from Rs.676.2 billion to Rs.1.77 trillion (Chart 3).

Not all of this was raised through instruments issued in the stock markets. In fact a predominant and rapidly growing share amounting to a whopping Rs.1.46 trillion in 2006-07 was raised in the private placement market involving, *inter alia*, negotiated sales of chunks of new equity in firms not listed in the stock market to financial investors of various kinds such as merchant banks, hedge funds and private equity firms. While not directly a part of the stock market boom, such sales were encouraged by the high valuations generated by that boom and were as in the case of stock markets made substantially to foreign financial investors.

Private placement also helped raise debt capital. According to the Securities and Exchange Board of India (SEBI), resources mobilised through the private placement of bonds rose from Rs. 1,185 trillion in 2007-08 to Rs. 3,615 trillion in 2012-13. The public issue of bonds, on the other hand, mobilised just Rs. 170 trillion in the latter year. As a result of the surge in private placement, outstanding bond-based corporate debt in India is reported by SEBI to have risen from Rs. 7,520 trillion at the end of March 2010 to Rs. 12,901 trillion at the end of March 2013.



The dominance of private placement in new equity issues is to be expected since a substantial number of firms in India are still not listed in the stock market. On the other hand, free-floating (as opposed to promoter-held) shares are a small proportion of total shareholding in the case of many listed firms. If therefore there is a sudden surge of capital inflows into the equity market, the rise in stock valuations would result in capital flowing out of the organized stock market in search of equity supplied by unlisted firms. The only constraint to such spillover is the cap on foreign equity investment placed by the foreign investment policy of the government.



However, it is not clear whether these sources can meet the needs for financing of infrastructural development in India. According to the official *High Level Committee on Financing Infrastructure* (Planning Commission 2012), infrastructural spending during the Tenth Plan (2002/03-2006/07) amounted to Rs. 9,161 billion at 2006-07 prices. On the other hand, projections for the Eleventh Plan placed investment during 2007/08-2011/12 at Rs. 20,562 billion of which 95 per cent or Rs.19,448 billion had been realised. This compares with disbursal in constant 2005-06 prices of Rs. 1473 billion

by leading financial institutions during the Tenth Plan, and Rs. 3,417 billion during the Eleventh Plan. Not surprisingly, the share of public investment in the financing of infrastructural investment was 78 per cent during the Tenth Plan and 62 per cent during the Eleventh. Thus, public funding, including direct funding from the government's budget, accounts for a significant share of infrastructural investment, though private investment has risen in importance.

One route through which private funding occurs is public-private partnerships that have grown in importance. According to the Planning Commission (2013), the World Bank has found that "India has been the top recipient of Private Participation in Infrastructure (PPI) activity since 2006 and has implemented 43 new projects which attracted total investment of US$20.7 billion in 2011. India alone accounted for almost half of the investment in new PPI projects in developing countries implemented in the first semester of 2011. The Report maintained that India remained the largest market for PPI in the developing world. In the South Asian region, India attracted 98 per cent of regional investment and implemented 43 of the 44 new projects in the region." But clearly this success is not unrelated to the willingness of the government to contribute substantially to these projects as investor and provider of support such as Viability Gap Funding under a scheme notified in 2006 "to enhance the financial viability of competitively bid infrastructure projects which are justified by economic returns, but do not pass the standard thresholds of financial returns." (Planning Commission 2013).

There has also been a set of new institutions that have been promoted to provide long term finance, often created with sponsorship from the state. Important among them is IDFC, created on the basis of the recommendation of the 'Expert Group on Commercialisation of Infrastructure Projects' in 1997. In 2003, IDFC raised $200 million for the India Development Fund, which was an 'infrastructure-focused private equity fund'. It has since gone to market repeatedly to raise resources. By 2009, the company (which by then had gone public and been listed) had lent more than Rs.200 billion (Rs. 20,000 crore) to 200 projects. IDFC is today India's predominantly private infrastructure financing company with the government's equity share down to just 18 per cent.

Another infrastructure company set up with government sponsorship was the India Infrastructure Finance Company Ltd (IIFCL), which commenced operations in 2006. The company supports infrastructure projects with direct lending, refinancing and takeout financing. Till the end of March 2013 the company had assisted 299 projects with sanctions of Rs. 51,88.87 billion and disbursals of Rs.265.82 billion.

In 1987, the Central Bank of India (CBI), Housing Development Finance Corporation Limited (HDFC) and Unit Trust of India (UTI) promoted Infrastructure Leasing & Financial Services Ltd (IL&FS) with the mandate to promote infrastructural investment in the country. As of now Orix Corporation, Japan (23.3%), Abu Dhabi Investment Authority (11.2%), HDFC (9.9%), Central Bank of India (8.4%) and the State Bank of India (7.06%) are the main shareholders.

Thus, over a period of time a set of quasi public and large private companies are being given the task of financially supporting infrastructural development in India. However, thus far, the burden of financing has fallen on the government. In fact, according to some observers the benefits of infrastructure promotion are garnered by the private sector and the costs borne by the government. When projects prove unviable, public or government sponsored entities suffer losses. But when profits are made, it is the private sector that is the beneficiary. With government finances under strain, this route to financing infrastructure development may prove difficult to sustain. Public investment financed with tax revenues seems to be the obvious but little favoured route to infrastructural provision.

Multilateral agencies and infrastructure finance

These trends on the domestic financial front have been considerably strengthened by the support they have received from multilateral institutions like the World Bank, the Asian Development Bank and the International Finance Corporation. While World Bank support for infrastructural investment in South Asia in general and India in particular fell from $9.5 billion in 1993 to $5.5 billion in 2002, partly because of evidence of damaging environmental effects, there has been a revival since then. Currently the World Bank is engaged in setting up a new Global Infrastructure Facility, which will combine Bank funds with investments by sovereign wealth funds and pension funds in securities floated by the bank, to finance infrastructure in developing countries. The ADB too has been an important player and has recently in October 2013 approved a $700 million facility to support the Government of India's drive to substantially increase infrastructural investment in the country.

Commercial banks and infrastructure development

Finally, what is noteworthy is that, with the decline of development banking and, therefore, of the provision of finance by the financial institutions (which have been converted into banks), the role of commercial banks in financing the corporate sector has risen sharply to touch 24 per cent of the total in 2003-04. Scheduled bank credit to large and medium industry rose by 727 per cent over the 10 years ending March 2012-13, growing at a compound rate of 25 per cent per annum. This compares with an increase of 266 per cent and an annual growth rate of 14 per cent over the preceding ten years. The ratio of scheduled commercial bank credit to GDP, which fluctuated in the 20-22 per cent range right through the 1990s, rose from there to exceed 55 per cent by 2012. This occurred during the period when GDP growth had accelerated. As a result, internal resources and bank finance dominate corporate financing and not equity and private development finance, which receive all the attention because of the surge in foreign institutional investment and the media's obsession with stock market buoyancy.

It is true that during this period the share of commercial bank credit flowing to industry had fallen from 48.8 per cent at the end of March 1998 to 39.6 per cent at the end of March 2011. But given the sharp increase in the overall volume of credit, this did imply that the absolute amount of credit flowing to the industrial sector was still high. The real change was in the direction of credit flow within the industrial sector, with a rising share flowing to the infrastructural sector. The figures are dramatic. The share of infrastructural lending in the *total advances of scheduled commercial banks to the industrial sector* rose sharply, from less than 2 per cent at the end of March 1998 to 16.4 per cent at the end of March 2004 and as much as 31.5 per cent at the end of March 2012 (Chart 4). That is, while the share (though not volume) of lending to industry in the total advances of the banking system has fallen, the importance of lending to infrastructure within industry has increased hugely. Four sectors have been the most important here: power, roads and ports, and telecommunications, and more recently a residual 'other' category, reflecting substantially, in all probability, the lending to civil aviation.

Under normal circumstances banks are not expected to lend much to these areas as it involves significant maturity and liquidity mismatches. As noted earlier, banks draw deposits from savers in small volumes with the implicit promise of low income and capital risk and high liquidity. Infrastructural investments require large volumes of credit and do involve significant income and capital risk, besides substantial liquidity risk. So what is required for supporting infrastructural investment is increased equity flows from corporate or high net worth investors and the expansion of sources of long-term credit like a bond market.

Neither of these, especially the latter, occurred in adequate measure. Rather, the development financial institutions with special access to lower cost financial resources, which were created as providers of long term-finance, had been shut down as part of liberalisation. Hence, besides recourse to external commercial borrowing, many infrastructural projects had to turn to the banking system. As is to be expected, private banks have been unwilling to commit much to this risky business. So it is the public banking system (besides a couple of private banks) that has moved into this area, possibly under government pressure, leading to the kind of losses that were exemplified by the collapse of Kingfisher Airlines.

There have been two other sources to which corporates have turned in their search for borrowed resources. One is to the domestic bond market, which though considered relatively inactive, has in recent years delivered significant funds through the private placement route. The other is to foreign lenders, through the increasingly liberalised external commercial borrowing route that has been energised with tax concessions.

India's external debt has risen sharply, more than doubling over a six-year period from $172 billion at the end of March 2007 to $390 billion at the end of March 2013. Much this $218 billion increase in outstanding debt is on account of private debt. Sovereign debt rose from $49 billion to just $81 billion, falling relative to GDP from 5 to 4.4 per cent between end-March 2007 and 2013. On the other hand, Non-Government Debt rose from $123 billion to $308 billion, or from 12.5 per cent of GDP to 16.7 per cent of GDP, accounting for 85 per cent of the increase in debt over those two points in time. Within the latter External Commercial Borrowing (ECB), which reflects corporate borrowing, rose from $41.4 billion at the end of March 2007 to $121 billion at the end of March 2013.

Thus, there are a variety of ways in which the gap created by the transformation of development finance was filled. There was a shift towards bank credit and external commercial borrowing. There

was a trend towards the sponsorship of new, non-government or quasi government development finance institutions, particularly for the infrastructural sector. There was increased reliance on internal resources. And there was a growing role for external commercial borrowing and private equity in corporate financing. All of these had implications that we return to later in this paper.

III. IMPACT/ASSESSMENTS

In sum, that the development banks were central to the industrialization and the development effort till the onset of liberalisation cannot be denied. Their resources were crucial and the choice of areas to which they were willing to lend, which was tied to the pattern of development prescribed by the Five Year Plans, ensured that the allocation of investment was moved in directions warranted by larger development goals. Further, with state control and influence over financing, projects that are supported can be chosen to privilege promoters, locations and technologies that would help ensure reduced concentration of economic power, greater regional dispersion of economic activity and the realisation of larger goals such as employment generation, foreign exchange saving and adherence to social and environmental standards. That some of these objectives were indeed kept in mind (however, inadequately) cannot be denied. But addressing the question of the extent of shortfall from some ideal is handicapped by the absence of benchmarks that can be reasonably set. This implies that the extent to which government intervention using the instrumentality of development banks failed is difficult to assess.

However, it is to be expected that the decline of development banking and state presence undermines even the possibility of pursuing goals of the kind mentioned above. If the financial sector is left unregulated, in economies with substantial private assets and an important role for private agents in investment decision-making, market signals would determine the allocation of investible resources and therefore the demand for and the allocation of savings intermediated by financial enterprises. This could result in the problems conventionally associated with a situation where private rather than overall social returns determine the allocation of savings and investment.

To start with, the allocation of investment may not be in keeping with that required to ensure a certain profile of the pattern of production, needed to ensure sustained growth. An obvious way in which this happens is through inadequate investments in the infrastructural sector characterised most often by lumpy investments, long gestation lags, higher risk and lower profit. Given the "economy-wide externalities" associated with such industries, inadequate investments in infrastructure would obviously constrain the rate of growth.

While factors such as this could limit the rate of growth, the private-profit driven allocation of savings and investment could also affect variables such as the balance of payments, the employment elasticity of output growth, and the regional dispersion of economic activity. It could aggravate the inherent tendency in markets to direct credit to non-priority and import-intensive but more profitable sectors, to concentrate investible funds in the hands of a few large players and direct savings to already well-developed centres of economic activity.

Environmental impact

An area in which this distortion caused by market-driven lending is visible is environmental protection. Globally, one impact of project financing that has received attention in recent times is the environmental fallout of the projects that are funded. The Finance Initiative of the United Nations Environmental Programme (UNEP) seeks to partner with more than 160 financial institutions across the world and persuade them to take environmental and sustainability concerns on board when deciding on project funding. To that end a set of Principles of Responsible Investment (PRI) and a Global Reporting Initiative (GRI) have been framed. More recently in 2003, ten leading banks together with the International Finance Corporation (the private sector financing wing of the IMF) declared adherence to the Equator Principles, which are voluntary guidelines for categorizing, assessing and managing environmental risks when providing project finance in excess of $10 million. The Equator Principles are reportedly based on the International Finance Corporation's (IFC) Performance Standards on Environmental and Social Sustainability, and on the World Bank Group's Environmental, Health and Safety Guidelines. In India, YES Bank and IL&FS have joined UNEP's Finance Initiative and IDFC has adopted the Equator Principles. However, it is too early to assess whether this declared commitment does make a difference in practice, especially since there is no formal, independent monitoring mechanism.

Overall, however, initiatives such as these have received only limited attention in India, where the environmental consequences of large projects are required by law to be identified and assessed through an Environment Impact Assessment (EIA) needed for obtaining environmental clearance from the government. The EIA that was an administrative requirement till 1994 was made mandatory for a range of projects through the EIA Notification issued under the Environment Protection Act, 1986. Financial Institutions and banks are not supposed to release funds unless environmental clearance has been obtained. This may be seen as taking the environmental compliance issue out of the purview of the DFIs, and placed in the hands of specialised bodies. Yet, there have been a number of projects funded by the DFIs that have been extremely controversial from an environment point of view (Mandal and Venatramani 2012).

Topping the list are projects in the power sector, especially hydel projects like the Maheshwar Hydro-Electric Project (HEP). Among the earliest of the Independent Power Projects (IPP), Maheshwar was awarded in 1993 to the Shree Maheshwar Hydel Power Corporation Limited (SMHPCL) set up by the S. Kumar's group, which had a major presence in textiles but no experience in power production. Estimates suggest that the project was expected to adversely affect more than 50,000 people inhabiting 61 villages in the Narmada Valley.

The Madhya Pradesh government signed a power purchase agreement (PPA) with SMPHCL guaranteeing purchase of power from the project for a period of 35 years at a price that, even then, was much higher than prevailing power prices. However, right from the beginning the project was under attack from civil society activists, because of the displacement it will result in and the adverse impact it would have on the livelihoods of the local population. As a result of the controversy all foreign financial institutions and potential foreign collaborators withdrew from the project, implying that the Rs.20 billion plus required to bring it to fruition had to be financed locally, with 30 per cent in the form of equity and 70 per cent in debt. The promoters, committed to contributing just 20 per cent of the equity, brought in initially only a fraction of that.

In the event, though the justification for bringing in a private promoter was to save on government financing, the Madhya Pradesh government (directly and through the electricity board), the IFCI, the IDBI, the Power Finance Corporation and a host of public sector banks ended up committing most of the financing required either as a combination of equity and debt, or just plain credit. Further, even though the project was not fully cleared on environmental and rehabilitation grounds, the financial institutions opted for premature disbursals of their contributions.

Unlike many other projects surrounded by environmental controversies, SMPHCL has not been able to start commercial operations, despite having displaced people, only 20 per cent of whom have been compensated. Close to two decades after the signing of the PPA, the MP government is considering cancelling it, and loans provided by the financial institutions have turned into NPAs, with no hope of recovery.

The problem occurs not only in power. Another case is, for example, the Lavasa super-high-end residential project launched in 2004 by Hindustan Construction Corporation (HCC) in a hill town near Mumbai. Being in the real estate area the project has attracted credit from private banks like ICICI Bank and Axis Bank, and not so much from the DFIs. The Lavasa project is under attack from the Ministry of Environment and Forests (MoEF) for not seeking clearance under the Environment Protection Act (1986) and for violation of the 1994 Environmental Impact Assessment notification. As a consequence the project has suffered huge delays and cost overruns, and has not been able to generate the revenues needed to meet its debt service commitments. Much of the company's debt is now non-performing.

There have of course been instances where companies have met environmental standards. A case in point is Indian Coal Mining Ltd (ICML) set up by the private sector Calcutta Electric Supply Corporation to manage the Sarshathali coal mines leased to it by the Ministry of Coal in 1993 in order to ensure coal supplies to the Budge Budge thermal power plant. The Environmental and Social Impact Assessment study commissioned by ICML set the cost of rehabilitation and resettlement at relatively high levels. ICML has reportedly not only delivered the resources, but used a tri-sector partnership approach—involving the company, government and civil society organisations—to implement the resettlement plan and to oversee afforestation efforts to compensate for the loss of tree cover as a result of the project. The company has received funding from the International Finance Corporation which is the principal financier of the project.

Role of Civil Society, Judiciary and Government

Even to the extent that large projects funded by Development Finance Institutions and the banks have been conscious of environmental impacts and attempted to follow national guidelines or international best practices, this has largely been the result of pressure from civil society, the judiciary and the government. India has had a long history of successful civil society opposition to environmentally damaging projects. An early instance was the Save Silent Valley Movement. In 1970 the Kerala State Electricity Board launched on a 240 MW hydroelectric project in Silent Valley, a virgin tropical forest stretching over 8950 hectares in Palghat District of Kerala State, that was justified by the power it would deliver to a power-deficit state, the irrigation it would offer across a 100 sq km area, and the jobs it would provide to a state afflicted by high levels of unemployment. However, what became clear as a result of the intervention of conservationists and environmental experts was that the project would destroy much of the tropical forest and with it much biodiversity, including the rare lion-tailed macaque.

Despite these warnings the governments at the state and central levels were adamant about going ahead with the project and received much support from the media, with a few exceptions. The project was formally approved in 1973. The official National Committee on Environment Planning and Coordination set up a task force chaired by Zafar Futehally, which while recommending that the project should be scrapped, also specified a set of safeguards that must be adhered to if the government does indeed choose to go ahead with the project. As expected, the government promised to implement those safeguards and decided to proceed with the project.

However, taking the cue from the warnings put out by naturalists, civil society organisations came together to launch the Save Silent Valley Campaign and opposed the project on the streets, through mass educational programmes and in the courts. After a long struggle that lasted nearly a decade the government announced its decision to call off the project and designate Silent Valley as a National Park (Dattatri 2011)

The Silent Valley Movement is seen by many as having provided the inspiration for subsequent civil society resistance to environmentally damaging projects, such as the Narmada Bachao Andolan and movement against the Tehri dam. Success has not been as marked in all cases, though the tenacity of these movements faced with adamant governments is indeed Impressive. The Silent Valley experience also pushed the government into establishing an environment clearance procedure involving, as noted earlier, a mandatory environmental impact assessment report to be submitted to the Central Government for any major project that had ecological implications. The EIA has been an important tool used by environmental watchdogs to introduce an element of transparency into project clearances.

There were two other instruments that have been used to monitor government provision of environmental clearance and ensure large projects are not environmentally strongly adverse even if not neutral. One is the use of the Right to Information (RTI) Act and procedure to obtain crucial information. The other is to turn to the courts with public interest litigation.

A revealing example of the use of the RTI Act to obtain crucial information, is the exercise of this right by Kalpavriksh Environment Action Group to obtain information on environmental impact clearance and monitoring in the case of eight dams: Teesta Low Dams 3 and 4 HEP (West Bengal), Teesta V HEP (Sikkim) Athirappily HEP (Kerala), Tipaimukh HEP (Manipur), Lower Subansiri and Kameng HEPs (Arunachal Pradesh), Parbati Stage II project (Himachal Pradesh) and Pala Maneri HEP (Uttarakhand) projects.

A case study (Kohli, Menon and Sansariya 2012: 7) on the use of this instrument concludes as follows: “The RTI Act has substantially helped in tracking the environment clearance, wild life related conditions (NBWL) and the compliance of environmental clearance conditions. By and large there has not been much delay in receiving information or the responses being incomplete. Since most of these were very specific to projects and did not require any processing of information, the MoEF has been prompt in providing the information. In on going campaigns however, this has been a critical source of information and will continue to be so.”

The experience with the courts has been mixed. There are many instances where the court has come out strongly in favour of environmental protection. A case in point is with respect to the mining industry in Goa. Indiscriminate mining leads to a host of problems such as reduction – or the drying up altogether

– of water sources (springs, wells), siltation of agricultural fields with mining silt leading to loss of livelihoods, and dust and noise pollution. These consequences led a flood of Public Interest Litigation (PIL) cases being filed in the High Court and even directly in the Supreme Court. In one of these cases, for example, the grant of post-facto clearances to industrial projects and mining leases was challenged, leading to an order that required all mining leases and several thousand industrial units to submit themselves for environment assessment. Many other similar victories have been won (Alvares 2009).

However, there have been instances where the courts have been reticent to intervene. Thus, in 2000, the Supreme Court in its judgement on the Sardar Sarovar Project refused to entertain submissions from the Narmada Bachao Andolan about the environmental effects of large dams. Noting that conditional clearance for the project had been given in 1987 it declared that pleas related to submergence, environment studies and seismicity could not be raised at that late stage.

III. CONCLUSION

The Indian experience thus far seems to be that government regulation, and instruments like the RTI Act and public interest litigation used by civil society activists and democratic forces, rather than guidelines and principles adopted by the development banks, have been the major agents for change with regard to concern for the environmental consequences of large projects. However, publicly supported and owned development finance institutions could have over time under government and civil society influence made a difference here. This would have been even more likely as and when environmental impact assessment became a central feature of planning for development, which is an emerging tendency.

Private financial institutions focused on profit are likely to be less willing to take on board environmental concerns, especially if they result in the loss of profit opportunities or reduction in profitability. But the pressure of activism within a democratic framework is forcing even largely private institutions to voluntarily adopt UNEP's Finance Initiative guidelines and the Equator principles.

It hardly bears emphasising that a multilateral development bank like the BRICs bank can serve as a developmental catalyst, especially for poorer countries. But such a bank must be provided access to resources at costs that makes the development banking objective feasible, it should be governed by a publicly accountable management and take on board civil society representative, it should be subject to social and environmental benefit goals and not just profitability requirements, and it should explicitly incorporate concerns such as sustainability into its agenda. India's experience with development banking suggests that it would be inclined to promoting greater private participation in financing the bank's activities and favour lending to projects that directly or indirectly ensure private profit rather than social benefit. Moreover, it is unlikely to emphasise environmental and social concerns when lending and investment decisions are made.

References:

Alvares, Norma (2009), "Political Struggle Through Law: The Public Interest Litigation (PIL) route to environmental security in India with special reference to the environment movement in Goa", **Goa Foundation**, available at http://goafoundation.org/wp-content/uploads/2009/06/The-PIL-route-to-environmental-security.pdf, accessed October 30 2013.

Chandrasekhar, C. P. (2011), "Six Decades of Industrial Development: Growth of the Manufacturing Sector in India", in D. Narayana and Raman Mahadevan (ed.), **Shaping India: Economic Change in Historical Perspective**, New Delhi: Routledge.

Chandrasekhar, C. P. (2013), "Fragile Foundation: Foreign capital and growth after liberalisation", **Social Scientist 476-477**, Vol 41 Nos 1-2, January-February.

Dattatri, Shekar (2011), "Silent Valley — A People's Movement that Saved a Forest", **Conservation India**, at http://50.22.83.82/case-studies/silent-valley-%E2%80%93-a-people%E2%80%99s-movement-that-saved-a-forest, accessed 30 October 2013.

Gerschenkron A. (1962), **Economic Backwardness in Historical Perspective: A Book of Essays**, Cambridge: Mass. Harvard University Press.

Goldsmith Raymond W. (1983), The **Financial Development of India, 1860-1977**, Delhi: Oxford University Press.

Kohli, Kanchi, Menon, Manju and Samdariya, Vikal (n.d.), "Right to Information Act and the Environment Impact Assessment Regime: A Case Study", Kalpraviksh Environemnt Action Group, available at http://www.kalpavriksh.org/images/EnvironmentandDevelopment/Check_Lists/PR/RTI%20Case%20Study%20on%20EIA.DOC, accessed September 30, 2013.

Kumar, Santosh (2013), **Decline of Development Banking During Financial Liberalization (1992-2004) in India: Determinants and Implications**, Unpublished Ph.D. Thesis submitted to Jawaharlal Nehru University, New Delhi.

Mandal, Koyel and Venkatramani, Vivek (2013), **Environmental and Social Risks in Project Financing: Evidence from India**,

Narasimham, M. (1998), *Second Committee on Banking Sector Reforms,* Reserve Bank of India.

Planning Commission, Government of India (2012), **Interim Report of the High Level Committee on Infrastructure Financing**, New Delhi, available at http://infrastructure.gov.in/pdf/Interim_Report.pdf, accessed November 30, 2013.

Planning Commission, Government of India (2013), **Draft Compendium of PPP Projects in Infrastructure**, New Delhi, available at http://infrastructure.gov.in/pdf/Draft_Compendium_of_PPP_Projects_in_infrastructure.pdf, accessed November 30, 2013.

Reserve Bank of India (2004), **Report of the Working Group on Development Finance Institutions**, Mumbai:RBI avaoilable at http://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/53674.pdf. Accessed 25 October 2013.

Reserve Bank of India (2013), **Handbook of Statistics on the Indian Economy 2012-13**, Mumbai 2013, also available at http://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Handbook%20of%20Statistics%20on%20Indian%20Economy. Accessed 1 November 2013.