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Infrastructure Is Key To Sustainable Growth

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Domestic infrastructure is already under tremendous stress. Current spending levels are not sufficient to take care of the ongoing 7 percent growth. On the other hand, the country must try to sustain 9 to 10 percent growth in the medium term. Better infrastructure is important for more efficiency of the productive sector. It is equally essential for inclusive growth. China maintained its high growth trajectory through infrastructure spending. It created infrastructure for future years as well, to sustain growth momentum.

The government has projected $514 billion infrastructure investment during the Eleventh Plan. The figure is based upon 2006-07 prices and may be about $600 billion according to current prices. The Centre projected infrastructure spending as 7.6 percent of GDP but there is a continuous shortfall in targeted investment. Hence, it becomes necessary to jack up investment to about 9 to 10 percent of GDP for the rest of the Eleventh Plan. We have to increase infrastructure spending by 1 percent of GDP every year till we reach 15 percent of GDP. It may even require about $1,000 billion in the Twelfth Plan.

The challenge is enormous but achievable. The global community's confidence in our democratic system is an added advantage. It improves risk perception over several countries, including China.

However, the first requirement is to remove all the hurdles which comes in the way of clearances or approval of any particular project. There must be an amendment of laws wherever essential. Then comes timely implementation. Delays lead to escalation in project costs, which affect financial viability. Both central and state governments have to facilitate faster implementation. The state government is especially important. Avoiding delays will motivate new investors.

The second challenge is to generate financial resources within the constraints of FRBM laws, restricting fiscal deficit. As long as infrastructure projects are financially viable, resources can be augmented through borrowings and equity funds, public or private. Hence, user charges have to be levied to generate income for serving debt or equity.

At the same time, user charges have to be affordable. Hence, the role of the government becomes vital for striking a balance between financial viability and affordability of user charges. In case of marginal cases, the government must plan viability gap funding. In cases such as village roads, sanitation, water supply and irrigation, user charges may be negligible and may be financed by the Centre through budgetary support.

According to a Planning Commission report, investment from the private sector and FDI was envisaged at 30 percent while the balance 70 percent would come from the government. However, it is up to the Centre to take the lead and kickstart the process. Once reforms and policy initiatives are in place and government investment starts picking up incrementally, private investment along with FDI is bound to follow. This figure may be even higher than 30 percent.

This requires a compromise for the initial two years on the fiscal deficit front. I firmly believe that after two years, fiscal deficit would definitely come down, with additional revenue from increased GDP. Private investment shall start replacing government investment in many sectors.

The Deepak Parekh Committee Report on infrastructure financing is a comprehensive document which suggests innovative methods and recommends changing regulations. I think the government should consider implementing these recommendations at the earliest. The report widely covers FDI, capital markets, insurance funds, forex reserves, equity funds, NBFC, fiscal recommendations and regulatory change. However, a few additional points are mentioned below.

Tax deferment as funding source

Incremental infrastructure spending shall obviously generate government revenue as excise, service tax, customs duty and VAT on related goods and services. It could roughly be 16 percent of project cost. Such revenue is otherwise notional and shall accrue only if investment takes place. Hence, 60 percent of such taxes can be deferred for five to eight years, depending upon project implementation or the gestation period.

This will easily provide about 9 to 10 percent funding for the implementing agency, public or private. It will not create any stress on government finances since it is notional revenue, that too, part deferred and not exempted. The option may be available with the government to convert it into equity at any stage after project completion.

Intangibles hidden value to be unlocked

The government has intangible assets like statutory rights - township development, advertisement rights, mineral reserves, natural resources or surplus land. Clubbing these together with infrastructure projects can enhance financial viability. For example, allotment of additional land for highway projects can facilitate development of townships and shopping malls to generate additional income for the developer.

Indian Railways and other PSUs have huge surplus land, which can generate resources. Likewise, power companies with captive coal blocks may be allowed to sell part of the production in the open market to generate additional income. Similarly, amalgamating irrigation, hydro power and tourist spot development can perhaps make the irrigation project financially viable.

Efficiency attracts new investment

Improving the efficiency of existing infrastructure projects

– particularly power, roads and ports – is essential to attract fresh investment. Efficiency enhances financial viability with affordable user charges. Privatisation is alone not sufficient for efficiency improvement. Competition enhances efficiency – as in the telecom and aviation sectors – as the customer has more choice. The consumer gets a fair price and the government is relieved of its investment burden.

A suitable policy initiative is required for the power, road, rail and port sectors, which constitute nearly 65 percent of infrastructure investment. Enactment of the Electricity Act 2003 promoted power generation to some extent but the implementation was not uniform in all states. Hence, power generators in a few states were not able to enjoy open market access at market rates. This becomes disincentive for fresh investment. A uniform policy and legislation with an investment friendly tilt is required, with due protection for consumers. Privatisation of power distribution companies has not yielded the desired results due to lack of competition. Commercial losses are still high and a cross subsidy is continuing. Hence, the desired level of investment has not been reached by distribution companies. This requires a review.

Efficiency in the roads sector has also not improved. Investments are high and user charges low due to public affordability. I think amendment of the M.V. Act – permitting 25 percent overload – shall facilitate efficiency and generate higher user charges from goods traffic.

In case of Indian Railways, the government may consider partial privatisation to create competition and to improve efficiency further. A central monitoring agency may compare the efficiency of various projects and give suitable advice. Once the efficiency of the existing infrastructure improves, I feel there will be no shortage of future investment from non-budgetary resources.

Sweat equity as alternative

Once infrastructure spending gains momentum and efficiency improves, investment sentiments will obviously become positive. Investment returns on equity are then generally better than debt instruments. Infrastructure companies can take advantage of it. They may negotiate with suppliers of goods and services to convert part of their receivables and purchase advance into sweat equity.

This will facilitate infrastructure companies in raising resources and ensure dedicated participation of suppliers for faster and efficient implementation. In other words, there will be a partnership with suppliers. This can generate resources anywhere between 5 to 10 percent of project costs, enhancing leverage for infrastructure companies. However, a suitable regulation for equity issuance, pricing, lock-in period and buy back must be redesigned with an investment-friendly tilt. This will provide more comfort to PSUs and large corporates undertaking infrastructure projects.

Leverage of PSUs, large corporates

The financial burden on the government through the budget always exist for rural and social infrastructure, where user charges are nominal. Hence, some burden of infrastructure financing has to be shifted on to central and state PSUs and cash rich corporates through sector-specific fiscal incentives.

Central PSUs like power, oil, gas, telecom and railways are as it is sharing the burden up to 35 to 40 percent. The highways and roads sector PSUs are yet to deliver along this line. The role of state PSUs is also inadequate, perhaps due to low leverage and expertise. The government may opt for disinvestment through the equity dilution route by raising additional equity in these PSUs. Infusion of fresh equity shall provide the additional leverage of raising further equity by an equal amount, keeping 51 percent holding intact. Additional equity raised through disinvestment or fresh infusion may be further leveraged for raising debt at low cost.

Similarly, a few corporates with a good track record may be permitted for additional equity through banking or insurance arms. This will give additional leverage to them for raising debt. The government may also consider promoting a few PSUs, specially in the roads and irrigation sectors, where participation is not significant at present. PSUs and large corporates can easily raise risk capital, which is an essential requirement in infrastructure projects.

Forex utilisation needs review

Basically, we need forex reserves for trade deficit and debt servicing. A cushion is needed for meeting eventualities of reverse flow. A fair estimate may be drawn for the desired levels of reserves on various considerations and norms. Beyond this, parking of forex reserves in US securities, the Bank for International Settlements (BIS) and the International Monetary Fund (IMF) is not contributing to the Indian economy. It means our forex reserves are financing development in other countries. Interest earned on such investment gets partly nullified from cost of currency management.

Part utilisation of forex reserves for infrastructure spending has been debated upon so many times. However, the fear of monetary expansion and the resultant inflation comes in the way. If IMF norms are coming in the way, they must be overcome through diplomatic channels. The Deepak Parekh Committee Report has recommendations based on spending and investing outside the country. One recommendation facilitates mobilising long term foreign debt at low costs.

We feel spending forex reserves within the country should not result in real monetary expansion or inflation. Monetary expansion shall result in inflation only if consumption increases without matching production, that is, goods availability.

If domestic savings are not enough to meet the investment requirement of infrastructure, we have to depend on foreign savings, that is, forex inflow. If we do not utilise forex reserves for this purpose, we have to raise foreign debt, which will also have a similar affect of monetary expansion. So why not to utilise our own reserves and save interest costs?

Prevailing viewpoints need due consideration by the government for part utilisation of forex reserves in direct

spending within the country. This will also help increase GDP. Otherwise too, revenue shall increase with infrastructure investment and GDP growth. Hence, effective utilisation of reserves requires a revisit. Temporary side effects may be ignored for a few months.

Channelising savings essential

Basically, the investment requirement for infrastructure is to be funded from domestic savings or forex inflow - debt or equity. It is thus essential to increase domestic savings from the present level of 35 percent to 50 percent of GDP by 2015. An increase of 1.5 percent every year could be feasible. Any major jump requires tax incentives and policy initiatives. Depending on domestic savings is better than forex inflow.

The Deepak Parekh Committee Report's suggestions on diversion of physical gold savings into the Gold Deposit Scheme are excellent. The government may also consider imposing an additional customs duty to discourage physical gold savings. Physical savings are about 10 to 11 percent of GDP and remain idle, not contributing to the economy. At least 50 percent of such physical savings may be diverted to infrastructure and the productive sector through banks/capital markets.

I think tax incentives in the long term fixed deposit with banks or corporates shall also promote savings. Raising income tax exemption limits and cutting down corporate tax shall also enhance savings for onward investment. Despite a large banking network, lots of savings are still not routed through the bank or equity market. A sizeable amount remains inert, mostly in small cities, towns and villages. This may be termed "inert money."

A systematic study is required to find out the exact reason, quantum and solution to bring this back into the mainstream. Similarly, invisible remittance to outside countries has to be curtailed. Such total inert money generation could be about 5 percent of GDP or more, which can be utilised for investment in infrastructure in larger public interest. It may be worthwhile to consider the words of home minister P. Chidambaram.

"In earlier columns, I have argued for rejecting the phobia about "foreign" money. I wish to make another controversial suggestion. Perhaps, for a certain period of time, we should be colourblind to 'black' money if invested in certain sectors... Can we not agree on a policy that allows for a period of 10 years new investment in the tourism sector...and promises that no questions will be asked about the source of funds? Agreed, there is an element of inequity in this proposal and the means are somewhat dishonest but this is perhaps one of the better examples where the ends would justify the means," he noted.

It was written in 2003, depending upon the then requirement of country, where our savings were dwindling below 25 percent of GDP and country needed funds for investment. The basic intention is, end result and ultimate public interest are superior to regulations, which can be amended. However, a balanced approach will at least arrest future generation of such money. An increase in savings and channelising it to infrastructure is the basic necessity without which dependency on forex inflow will remain high.

Debt raising needs matching equity

According to the Planning Commission report, funding of infrastructure investment through equity and internal accruals is about 48 percent. Commercial banks also have to enlarge their equity base for matching lending capacity. Hence, fresh equity is very essential. The Deepak Parekh Committee report has given innovative recommendations related to supplier's equity, venture and private equity funds. Besides this, the capital markets have to be vibrant. Volatility has to be arrested to create confidence. Limited intervention of insurance or pension funds and banks is essential for a stable market.

This will provide huge equity funds through FIIs as well as domestic investors. Equity investment in infrastructure companies and banks should also get some tax incentives or immunity. Equity funds provide leverage for debt raising. Otherwise too, infrastructure requires risk capital, which comes from the equity route only. Even IIFCL and other financing arms of the government may consider part financing through equity instead of debt. This will increase overall leverage for fund-raising. This may ultimately reward financing arms on the portfolio as a whole. Obviously, equity is thus the starting point before raising debt.

Insurance/pension fund are long term

Most infrastructure projects require low cost and long term debt for 10 to 15 years. There is a shortage of this type of debt with the domestic banking sector and hence, we are to depend on foreign banks and institutions. On the other hand, there is appetite with insurance and pension funds for long term debt lending.

At present, such non-government debt in insurance companies is hardly 10 percent of their portfolio. Exposure with pension funds is perhaps nominal. The government should enlarge utilisation of insurance and pension funds for this purpose. Suitable regulations, in line with the Deepak Parekh Committee report, may be formulated for the insurance sector. Pension funds may be also be included in such regulation. Additionally, they may be permitted to invest in equity of such infrastructure companies to some extent.

To sum up, Infrastructure is the key for revival as well as to sustain growth. We have a lot of expectations from the present government and its visionary leadership. We are confident that results will be delivered this time. It is now time for us to accept the challenge of building world class infrastructure through a series of reforms and bold initiatives. ■

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