External borrowing eased in three embattled sectors

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India's Union Budget projected a growth rate of 7.6% over the fiscal year that started on 1 April. Among the critical sectors having a bearing on the attainment of this target are civil aviation, power, and roads and highways.

Recognizing the need for low-cost funding for players operating in these sectors, the Reserve Bank of India (RBI) has issued a flurry of circulars liberalizing the external commercial borrowings (ECB) regime to improve the current state of affairs.

Clearer skies for aviation?

The Indian civil aviation sector has been in the news in recent times, most often for the wrong reasons. The Union Budget contained several concrete proposals to get the industry out of the doldrums.

To this end, the RBI has conditionally permitted licensed Indian operators to obtain ECBs for the purpose of working capital, which previously was not allowed. According to the RBI circular, a borrowing limit of US$300 million would apply to an individual company within the sectoral ceiling of US$1 billion. Further, such borrowings are required to be raised within 12 calendar months from date of issue of the circular and must have a minimum average maturity period of three years.

The ECBs have been placed under the approval route, which means the authorities have retained a significant say in the process. The circular stipulates that permission to use ECBs would be based on criteria such as the company's cash flows, foreign exchange earnings and debt-servicing capabilities.

While international bodies believe that the Indian civil aviation market is poised for exponential growth in the near future, the present is far from rosy. Domestic carriers have to surmount a host of challenges such as debt servicing, rupee devaluation, labour issues and increased operating costs, primarily stemming from spiralling aviation turbine fuel bills.

Although accessibility to comparatively cheaper foreign loans might be alluring to Kingfisher Airlines and other cash-strapped domestic carriers, the presence of riders such as the requirement of ECB liability to be settled entirely through foreign exchange earnings might prove to be a bridge too far.

Road to power

Another thread in the narrative of the push for infrastructure development, as mandated by the recent Union Budget, is the RBI's liberalization of the ECB regime in the roads and power sectors in terms of permissible end use of the borrowed funds.

The new regulations permit application of ECB funds for the operation and maintenance of toll systems for roads and highways, provided that such a system had featured in the original plans of the road project in question. Moreover, accessibility has been ensured by placing such capital expenditure under the automatic route.

Similarly, in the context of the power sector, up to 40% of funds raised through fresh ECBs can now be used under the approval route to refinance domestic loans for completed infrastructure projects. Prior to this circular, ECBs could be used to refinance up to 25% of domestic loans, a measure introduced only in September 2011.

One of the requirements for such external finance is that at least 60% of the funds raised must be used for project-related capital expenditure.

Timely moves

The above changes are the need of the hour considering the prevailing bottlenecks to domestic funding in these sectors. In this bleak situation, the RBI's permission to access comparatively low-cost foreign debt funding is a veritable lifeline to such specialized infrastructure players.

The proposal made in the Union Budget to slash the withholding rate of tax on interest payments for ECBs to 5% from the existing 20%, if passed, would further enhance the attractiveness of such financing.

Trick of fate

Ironically, shortly after the announcement of these much needed reforms, the international rating agency Standard & Poor's (S&P) downgraded the outlook on India's long-term rating from stable to negative. For Indian borrowers looking to cash in on the liberalized ECB regime, the timing could not have been worse, with the revised rating likely to make potential lenders have second thoughts about exposure to Indian debt.

Among the reasons cited by S&P were lowered expectations on the timely delivery of significant economic reforms. This should serve as a warning to the government and spur it to champion the implementation of much needed changes.

While the current ECB liberalization package is welcome, more is required from policy makers if further chapters are to be added to the Indian growth story.

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