

THE UNION BUDGET 2012: GIVING INFRASTRUCTURE ITS DUE?

If recent budget proposals are anything to go by, the government is finally giving the sector the importance it deserves as the backbone of the Indian economy, or is it? Only April end will tell.



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Introduction

The ides of March signify an important event in the Indian financial calendar, with the announcement of the annual Union Budget heralding the roadmap of the Government's economic plans and policies in the next fiscal year.

For India's Gross Domestic Product (GDP) to achieve its stated target growth rate of 7.6%, an increase from its present levels pegged at 6.9%, the Government has sought to comprehensively augment India's potential in the agriculture, manufacturing and service sectors by focussing on development of its infrastructure—for long India's bugbear. To this end, the Budget proposes to invest an amount to the tune of Rupees

50 trillion over the 12th Five Year Plan (2012-2017) in this sector.

Harmonized Master List

While the infrastructure sector has been at the forefront of recent policy initiatives, there has been, a long-standing regulatory ambiguity about what constitutes infrastructure, with various agencies and bodies subscribing to conflicting definitions or leaving the term undefined, to be interpreted according to industry/ sector specific custom and usage.

To resolve this long-standing imbroglio, the approval of the harmonized master list of infrastructure sub-sectors,

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released by the Cabinet Committee on Infrastructure prior to the Union Budget, was announced in the Finance Minister's speech. This list, meant to guide agencies 'responsible for supporting infrastructure in various ways', contains five categories further sub-divided into 29 sub-categories and includes the education sector, hospitals, cold chains and telecommunication networks and towers.

The harmonized master list envisages a committee comprising representatives, from institutions such as the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), the Insurance Regulatory and Development Authority (IRDA) and the Planning Commission empowered to consider inclusion of further sub-sectors based on stipulated guiding parameters. Thus, the master list goes beyond a mere exercise in semantics, it lays down the mechanism and principles by which the existing list can be updated and amended thereby ensuring that the definition keeps pace with changing trends and is not rendered archaic with current market practices. Its acceptance would lead to reduced timelines as conferring infrastructure status will no longer be based on vague and subjective standards.

Public Private Partnerships (PPP)

Infrastructure, being a pure public good characterised by non-excludability and non-rivalrous consumption, holds little appeal for profit-oriented ventures. The requirement of substantial investment, a long gestation period and generation of low commercial return (as compared to its high social return) has led to a

scenario where the Government has been by and large responsible for the creation and maintenance of domestic infrastructure.

However, private enterprises have much to offer and, by marrying their efficiencies and specialized skills set with the resources of the State, can contribute significantly to the Indian growth story. With greater private participation in the infrastructure sector being the new age mantra of the State, measures to achieve the stated objective of raising half of the Plan period investment (Rupees 25 trillion) from such sources have been explored in the Budget.

One such proposal is linked to expansion of the existing scheme of Financial Support to PPP in Infrastructure. Therein, by allocation of grants from the State to its private partner, a scheme for construction/ maintenance of infrastructure is rendered commercially viable. Another benefit of this kind of arrangement, known as viability gap funding (VGF), is that as the financial outlay of the Government is limited to only providing the marginal cost - namely this subsidy - it enables its resources to be spread over several projects and reduces the duration of the lock-in period. The Budget has proposed addition of, among others, irrigation, terminal markets, soil testing laboratories, oil and gas pipelines, telecommunications and telecommunication towers to the existing list of sub-sectors eligible for VGF.

Similarly, it has been proposed to permit defence public sector undertakings to enter into joint ventures under the PPP umbrella. As per certain reports,

India was the largest importer of arms for the period 2007-11 and has been looking to upgrade and modernise the equipment for its armed services, touted to be amongst the largest in the world. This would ensure that its defence procurement is adequately safeguarded while achieving global standards due to increased competition in a market estimated to be worth USD 100 billion over the next five years.

Debt Financing

Pure private funding, especially from overseas sources such as investment and pension funds, is also sought to be tapped through the creation of specialized vehicles like Infrastructure Debt Funds (IDFs). With an initial size of Rupees 80 billion, India's first IDF was created following the PPP model, with the promoters of the non-banking financial company being ICICI Bank, Citibank, Bank of Baroda and Life Insurance Corporation of India. IDFs may also be set up as mutual funds, thereby offering a greater diversity of options for investors seeking to participate in India's economic boom.

The Budget also provides for raising funds from the market through tax-free bonds amounting to Rupees 600 billion, doubling the limit announced in the previous financial year. Of this amount, it is proposed that bonds be raised by government institutions such as Indian Railways Finance Corporation (IRFC), National Highways Authority of India (NHAI), India Infrastructure Finance Corporation Limited (IIFCL) (Rupees 100 billion each) as well as Housing

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and Urban Development Corporation Limited (HUDCO), Small Industries Development bank of India (SIDBI) and the National Housing Bank (Rupees 5 billion each). Similarly, it was proposed to issue bonds for ports and the power sector to the tune of Rupees 5 billion and 10 billion respectively. Last year, these bonds proved to be a big hit, especially among retirees and high net individuals, due to their high interest rates coupled with tax benefits.

Dedicated infrastructure financing entity IIFCL has got a further fillip with the Government pledging financial support of Rupees 4 billion as well as permission to increase its authorised capital to Rupees 50 billion, which could further increase up to Rupees 80 billion subject to approval from the Finance Ministry. These measures, coupled with the decision to place it under the supervisory domain of the RBI, would greatly enhance the ability to carry out its designated role of acting as a disbursal agency rendering long term financial assistance to infrastructure projects.

The Budget has also made several proposals broadening the extant External Commercial Borrowings (ECB) regime. The envisaged scope of permitted end usage would now include part financing rupee debt of existing power projects, operation and maintenance of toll systems for roads and highways, working capital of the aviation industry and low cost housing projects in urban areas. Tax based incentives have been suggested, such as lowering the rate of withholding tax for interest payment on ECBs to 5% from its current level of 20%

for a period of 3 years, to attract such funding in the infrastructure sector. While announcement of an increase in the annual ECB cap is yet to be made, the success of this experiment could lead to a gradual accretion of infrastructure related permissible end uses in the near future.

Projects

The National Highways Development Programme (NHDP) was given an ambitious mandate of achieving 8,800 kilometres of roadways construction by the next fiscal year, along with a purse of more than Rupees 250 billion—an increase of 14% from the last financial period. One of the stated aims of the Union Budget was ensuring ‘faster, sustainable and more inclusive growth’. Perhaps with this in mind, an allocation of Rupees 240 billion was earmarked for road construction in rural areas under the *Pradhan Mantri Gram Sadak Yojna*. These proposals have been widely hailed by analysts, with the real estate sector being a major gainer of the anticipated trickle-down effect due to the ensuing improved connectivity.

Similarly, rural infrastructure has received a boost with 25% of the total amount of Rupees 200 billion sanctioned to the Rural Infrastructure Development Fund being allocated exclusively for construction of warehousing facilities. This fund, administered by the National Bank for Agriculture and Rural Development (NABARD), is dedicated to financing projects at the State level and would go a long way in ending oft quoted horror

stories of rotting grains due to lack of adequate storage facilities.

Formal approval was also granted for the sanction of Rupees 185 billion over the next five years towards the Delhi Mumbai Industrial Corridor—a dedicated freight network connecting India’s political and financial capitals. This mega-infrastructure project, built in collaboration with Japan, will dramatically alter the surrounding landscape, over 1,400 kilometres across 6 states, by creation of holistic infrastructure such as power, roads, rail, ports, and mega industrial zones.

Conclusion

Thus far, the Indian success story has been a case of rapid development despite prevailing bottlenecks. The present Budget proposals reflect a marked change in the Government’s vision in recent times, which duly recognizes infrastructure as the backbone of the economy and a catalyst for further growth. Refreshingly, this Budget acknowledges the potential of the private sector which needs to be backed up with substantive reforms in various spheres, including political hot potatoes like land acquisition, if it wants to convince the rest of the world about the sincerity of its intentions. All eyes are now trained on the Parliament, which will consider the Budget proposals during the last week of April. 

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