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Budget 2016: Will Rs2.21 trillion for infrastructure be enough?



Absence of a vibrant bond market made banks the prime lenders. Photo Mukul Mudgal



The sustainability of India's growth trajectory and the success of government's flagship schemes such as Make in India, Startup India and Swachh Bharat are critically dependent on reducing the country's infrastructure deficit. Keeping this in view, despite fiscal constraints the finance minister has announced an enhanced outlay of Rs2.21 trillion for infrastructure in the next financial year. But would this be enough?

During the 12th Five Year Plan, the investment requirement across 12 infrastructure sectors was pegged at Rs55.75 trillion (8.18% of the gross domestic product, or GDP). The private sector was expected to contribute 48% of this, whereas the share of the central government and state governments was projected

at 29% and 23%, respectively. About 50% of the outlay was to be funded through debt.

The envisaged investment is unlikely to materialise. Woes of the banking sector, over-leveraged corporate balance sheet, inability to free capital locked in toxic assets, competing demand on public funds, supply-side constraints and the requirement of containing fiscal deficit have all contributed to this shortfall, which as per some estimates is expected to exceed 30%.



In the absence of a vibrant bond market and lack of low credit risk securities for channelizing long-term savings into infrastructure building, banks perforce had to become the prime lenders to this sector. They were ill-placed to do so. Constrained by an asset-liability mismatch and credit appraisal ability, the result was a high level of non-performing assets. This has held back, to a significant extent, investment during the 12th Plan period.

Insurance and pension funds are a repository of long-term savings, and should have been the first choice of lenders to this sector. However, given the complex risk profiles of public-private partnership (PPP) projects, they have lacked the appetite to invest in infrastructure.

Over 75% of this projected expenditure during the 12th Plan was to be ploughed into four sectors—electricity (both conventional and non-conventional), roads and bridges, telecom and railways. Each sector is facing a resource crunch albeit for completely different reasons.



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A large number of state power distribution companies are financially distressed, having accumulated huge losses over the years. Year after year, they face an expenditure revenue mismatch. Mounting losses reflect a governance deficit, an outcome of the political executive's conscious decision to avoid the political fallout of cutting transmission and distribution losses. To attract private investment, this governance deficit has to be bridged. The Ujjwal Discom Assurance Yojna scheme may provide temporary relief but sustainability of reforms and non-recurrence of the problem of failing distribution companies will be ensured only if their revenues cover costs. The irony of power plants forced to operate at sub-optimal plant load factors and simultaneous power cuts, on account of distribution companies' inability to purchase power, will inhibit the flow of investments. The policy challenge to force the state's hand to do so, through a set of incentives and disincentives, will go a long way in reviving the investor interest in the sector.

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Railway and roads are the fate lines of the country. The capital expenditure of Rs1.21 trillion estimated for railways for the next year is clearly an aspiration. Every Indian who has to undertake a train journey or utilise its freight resources would wish that the innovative measures to raise adequate resources, referred to in the rail budget, bear fruit. Their materialization is necessary to put this sector back on track.

The road sector has seen traction during the current year. Serious efforts have been made to clear the logjam over legacy contractual issues in the PPP mode. The assurance of renegotiation of PPP projects will be awaited with interest by investors. The increased gross budgetary support for the road sector and Pradhan Mantri Gram Sadak Yojana is a promising initiative. However to be translated into outcomes, implementation challenges will have to be addressed. One of these, which is seldom highlighted, is the contracting ecosystem. Contractors, who are the bedrock of this system and have the capacity to deliver quality civil works on time, have to be nurtured and encouraged.

Private investment has been the mainstay of the telecom sector. Investment in telecom and, oil and gas saved the day for the infrastructure sector in the 11th Plan, enabling it to attain a level of 7.21% of GDP, up from a corresponding figure of 5.04% in the 10th Plan. Over 90% of the Rs9.44 trillion investments in this sector during the 12th Plan period were expected to be privately sourced. This is unlikely to materialise. Further, there is a trade-off between investment in telecom infrastructure and spectrum fee. Higher Internet speeds, which require upgradation of infrastructure, will need a policy decision to attain a balance in this trade off. A word of caution—auctions in the sole pursuit of revenues should not become a winner's curse. The flow of investment will critically depend on this nuanced policy decision.

Infrastructure is the foundation of growth and innovation drives growth. This has been given due priority in the current budget. However, in the absence of supplementation by private sector debt and equity, the infrastructure deficit will continue to be a drag on the government's flagship programmes.

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