Where india can source 1 trillion dollars economics essay

Economics

Introduction:

Infrastructure is the buzzword in the present Indian context as there is a huge gap between demand and supply, this was the reason infrastructure funds were best performers in India in the past two years, adding the investment of $500 billion expected in the country's infrastructure should trigger more money into infrastructure funds.

What is Infrastructure?

Infrastructure activities, such as power, transport, telecommunications, provision of water, and sanitation and safe disposal of waste, are central to the activities of the household and to economic production. Without any of these either economic production will suffer or the quality of life will deteriorate. One could thus view these activities as essential inputs to the economic system. The image above projects the amount needed to be invested in infrastructure by the year 2020. It is a tall ask, even for a country as big as India.

Situation Analysis:

The image above shows the response of people who were asked the reasons making India a difficult country to run a business. It can be clearly seen that inadequate supply of infrastructure leads the reasons for the loss of many business opportunities India could attract. Indian government being increasingly worried about China’s growing economic and political threat over India is seriously lacking behind China in terms of infrastructure. Infrastructure is one of the key components for an economic development of a country. Around $1 Trillion is needed to sustain the growth of India over the next 5 years. Although rapid strides have been made in industries such as Telecom and Technology throughout the country still the overall basic infrastructure scenario in India is still largely inadequate. Essential areas such as Power, Transport, and Education etc. are low in standards when compared with other developing countries like China, Brazil, and Russia. The 1. 1 billion populations are already putting stress on the existing limited resources which makes it the primary objective for government to address this issue as first priority as recognized in the eleventh five year plan. The picture below sums up the existing condition in India and the need for change.

Indian Infrastructure Debt Fund (IIDF):

The UPA government had recently set up a 15-member committee under the chairmanship of former HDFC chairman Deepak Parekh to work out the modalities of the proposed India Infrastructure Debt Fund (IIDF). This is a proposal for setting up an India Infrastructure Debt Fund (the " Fund") for Rs. 50, 000 crore ($ 11 billion) to meet the needs of long-term debt for infrastructure projects that are set up through Public Private Partnerships (PPP). The Fund will also help bridge the emerging gap in the total debt required for funding infrastructure projects which presently rely on commercial banks. The provision of low-cost long-term debt is necessary for reducing the cost of infrastructure projects and this Fund would be a significant step in that direction. The Fund would only lend to projects that have entered into commercial operation after completion of construction. This would imply taking over of the existing debt of commercial banks and thus releasing their lending space for provision of loans to new projects.

When the Fund is fully operational, it will also help create a secondary market for debt bonds. Since infrastructure funds are long-term funds the payback period will also being longer. So they need to be financed long-term in order to be sustainable and cost effective. Infrastructure projects have so far being financed by banks, now facing the practical difficulty in providing long-term debt due to their asset-liability mismatch. IIDF hopes to address the deficit of the past years and for 01. 06. 2010 and keeping pace with the needs of a rapidly growing economy. The Eleventh Five Year Plan has set a target (revised) for scaling up investment in infrastructure from about 5% of GDP, as prevailing in the Tenth Plan, to 8. 4% by the terminal year of the Eleventh Plan (2011-12). In absolute terms, this implies an investment of about Rs. 20, 54, 000 crore (US $ 513. 55 billion) during the Eleventh Plan as compared to Rs. 9, 06, 074 crore ($ 227 billion) during the Tenth Plan. For achieving this sharp increase in investment, the role of the private sector would have to be enhanced besides an increase in public sector outlays. It is envisaged that 36% of the total investment during the Eleventh Plan would need to be mobilised from the private sector as against 25% achieved during the Tenth Plan, which implies an increase from Rs. 2, 25, 200 crore ($ 56 billion) in the Tenth Plan to about Rs. 7, 43, 000 crore ($ 185 billion) during the Eleventh Plan

Debt Gap:

According to the Eleventh plan of Rs. 7, 43, 000 crore ($ 185 billion) would require an equity contribution of about Rs. 222, 900 crore ($ 56 billion) and debt of about Rs. 520, 000 crore ($ 130 billion). In addition, the debt required for public sector projects has been projected at Rs. 506, 000 crore ($ 126 billion). Thus, the total debt requirement for infrastructure would be Rs. 102, 6000 crore ($ 257 billion). Projections for debt resources that are likely to be available for infrastructure suggest that there would be a gap of Rs. 201, 300 crore ($ 50 billion) during the Eleventh Plan period. However, this gap has not surfaced during the past three years mainly because of the slow roll-out of projects on account of several reasons including the global financial crisis. This situation is likely to change as some recent initiatives of the government, coupled with a simplified and standardised policy and contractual framework, are likely to lead to an accelerated roll-out of projects to be undertaken by private entities through Public Private Partnership (PPP). The more recently forecasted figures show that the debt gap has increased to about $500 billion by the year 2015.

Proposals:

FDI:

The image above shows the investment opportunities available in India. FDI’s are a paradox which has to play the major role in meeting the infrastructure funds needed by India. The reason it is a paradox is because FDI’s are difficult when the existing infrastructure in itself is strained still FDI’s continue to pour in India because of the other factors which counter balances against the infrastructure negativity. As government plans for more and more divestments of the primary infrastructure sectors like Energy, Transportation, Communications FDI’s in India is expected to grow significantly larger and make the large portion of the funds needed to meet the infrastructure -requirements of the country. In a bid to make the core sector attractive for FDI, the Cabinet Committee on Foreign Investment

(CCFI) has modified the 49 percent cap on foreign equity in the infrastructure sector. This major policy decision which will indirectly raise the foreign equity investment in infrastructure sector to well over 51 per cent, if a domestic partner fails to meet his commitment from internal sources, including borrowing. The new mechanism is designed to overcome the constraints for foreign equity cap in the infrastructure sector. Under the norms, companies operating in the sector can bring in equity through the mechanism of an investing company for the purpose of making investment in a licensee company in the service sector where there is a prescribed foreign equity cap.

Privatization:

Increasingly the government is forced to take measures to divest its holdings from the public sector companies for more investments to meet the challenges of overshooting demand. Privatization or Divestment as the government prefers to call it will change the role of government from operator to a facilitator and regulator for essential services/products in the country. Access to the most important areas of public will open the real floodgates for investments in infrastructure. Government can also sit back and efficiently manage the industry by monitoring and guidance. It has been a success story on opening the communication and technology markets for private players but India should also retrospect the condition of the education system where private players are dominant but still the standard of education remains poor and revamp its policy in a fool proof manner. In some sectors where privatization is almost unavoidable like Airports, Ports etc., government needs to be more careful before trying to privatize sectors like water and education where the cumulative impact on the economy will be much more than the facing failures in sectors such as Transportation.

Trade Agreements:

Trade agreements are expected to bring in new investment opportunities into India over the next half a decade. The major one being the Nuclear deal signed with the US. This deal is expected to fetch India $150 billion in the next decade for nuclear power plants. The resilience of the government to pass the nuclear bill in the parliament despite the risk of losing power emphasizes the importance of this deal and how acute India's energy shortage is. This is the largest sum expected to share the infrastructure gap India is trying to fill provided the deal materializes. India is also negotiating a Free Trade Agreement with the six-nation Gulf Cooperation Council, for greater investment from the UAE, asking the oil-rich country to be a part of its growth story, especially in the infrastructure sector. It is specifically targeting UAE as both countries already have a bilateral trade worth $44 billion and they want to capitalize over the benefits available. India has also indicated the outstanding results achieved in return to the $1. 5 billion invested by the Abudhabi government. India in turn has also shown the political will to engage with countries which have completely different political policies such as Iran and Myanmar to meet its future energy requirements. For a very long time negotiations have been going with Iran for a gas pipeline to get its share of 6600 MWh produced in Iran. It is $10 billion joint venture project by India.

Infrastructure Bonds:

Strong forex reserves, high domestic savings by Indians and a robust economic growth driven by strong capital markets and sturdy private sectors enable the government to invite (PPP) public private partnership. Government can issue infrastructure bonds bringing public and private firms together to invest in those bonds and the funds will be used for infrastructure development. The initial offerings from IDFC and L&T infrastructure bonds were a damp squib among the people but the government is still optimistic about its offerings is planning to come out with a new set of offerings in the form of tax exemption up to 20000[Refer appendix 1 & 2]. Rural Electrification Corporation (REC), Power Finance Corporation (PFC) and India Infrastructure Finance Company (IIFCL), will approach the market by December-end to lure investors with tax-free options. The two significant economic factors playing vital role in the investment decisions in the infrastructure bonds are Inflation and interest rate movements. Infrastructure bonds help in controlling both. The infrastructure bonds will give a new instrument to banks, which at present depend largely on the cheaper current account and savings account deposits for a bulk of their funds. The tenure of these bonds is 10-years, with a lock-in of five years.

Conclusion:

If India plans to spend $514 billion -- with private firms contributing 36 percent -- to overhaul its creaky infrastructure that is an obstacle to achieving faster growth in Asia's third largest economy. India expects private firms to fund half of the projected $1 trillion investment in infrastructure between 2012 and 2017. The four ways mentioned above are the most conventional ways to source the $1 trillion needed provided it handles the practical challenges in accomplishing them like Corruption, Inefficient bureaucracy, Maintenance, Risk factors in long-term debt, Entry and Exit barriers, Diplomacy etc… If one angle of sourcing the money exists government should counterwork on the opposite angle on minimizing this $1 Trillion. Efforts should be encourage and adopt innovative strategies which should act as a catalyst for the infrastructure growth. Companies performing CSR activities with direct impact on infrastructure should be given more tax benefits (Ex: A company adopting a local village). More Indian universities should tie up with universities worldwide to be knowledge updated. Indigenous research should be made to develop a knowledge repository. Joint Ventures on infrastructure projects should be encouraged by the government especially with technically advanced countries like Japan. Efforts should be made starting from policy level to move to cleaner energy and ecofriendly environment to reduce infrastructure spending.

References:

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Appendix:

Appendix 1

Tax Rate

Investments in Infrastructure

Slab

Tax Savings

Returns

After 3 years30%6, 0002, 00020%4, 00027, 48510%2, 00025, 485Obligatory

Returns to defy Inflation Effect

25, 194