Financing infrastructure projects to fuel economic recovery

Dr Harish Sharma, executive director, REPL, makes a point

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Infrastructure is the lifeline of any modern economy and India is no stranger to this fact. It is estimated that India can add up to 2 percent in its annual GDP by providing adequate infrastructure to its industry. The Prime minister's speech on the 15th August about the announcement of the National Pipeline project has provided a whole new direction to the infrastructure of the country.

The government has identified around 7000 infrastructure projects under the new National Pipeline project and will spend Rs 110 lakh crores to boost the overall infrastructure of the country with an aim to create unified infrastructure across the nation. If successful, the National Pipeline Project will be no less than a revolution in the Indian infrastructure sector and will be the single most important factor in the economic recovery of the nation.

The ambitious National Pipeline project is intended to provide seamless infrastructure connectivity to the remotest & the most left-behind areas of the country and bring them to the mainstream. It is expected to increase the efficiencies, save time and reduce wastage throughout the India. One of the most important objectives of this project is to make the basic necessities like electricity, healthcare, telecom, public transport etc available to every citizen of the county and upgrade their standard of living. However, no matter how well planned any project is or how noble the objectives are, the burning question always remains the same, how to finance the project? Financing of the National Pipeline project and raising the Rs110 Lakh crores will be the first major challenge faced by the government in course of revolutionising the infrastructure sector.

Financing of infrastructure projects is a rather complicated process. Very high investments, long gestation periods, high sunk costs, sovereign risk, social & environmental issues etc make it extremely difficult to finance any such project. Therefore, governments need to be innovative and device new methods to fund these projects.

Let us discuss about some possible avenues available with the government to meet the objectives and put the pedal on the accelerator.

Asset based Financing is a financing arrangement where the owner transfers the lease or the operational rights to the financer for a contractual period of time. Public Private Partnerships (PPP), Structured financing options, Lease financing and Hire Purchase financing are some options for project finance under Asset based financing.

Public Private Partnerships (PPP) are one of the most preferred infrastructure financing models across the world. In India there are several infrastructure projects successfully financed through PPPs. The PPPs have several models such as Built Operate Transfer (BOT), Build Own Operate Transfer (BOOT), Build Operate Lease & Transfer (BOLT), Annuity, Hybrid Annuity etc. While PPPs have been a successful option to finance infrastructure projects, the avenues for private finance are very limited especially in the current economic scenario dented by Covid-19. While entering the PPPs the government needs to be wary of the policy & the regulatory gaps and the need of the skilled workforce to handle the public part of the projects.

Infrastructure bonds can be another option for the government to finance the infrastructure projects under the National Pipeline project. These bonds serve as an alternative debt funding source for large projects. They also help mitigate the financial risk to a great extent. These bonds are often a cheaper source of finance for the project managers and help tap the assets of institutional investors. For institutional investors infrastructure bonds present opportunities for higher returns while for individual investors they bring returns as well as tax benefits. However, these bonds might fail to attract the risk averse investors.

Foreign Direct investments (FDI) are another useful source of finance for infrastructure projects. The Government of India has been gradually easing the norms for foreign direct investments in the infrastructure sector and currently up to 100 percent FDI has been allowed in select sectors. While FDIs are and have been a great source of finance for projects in India, it might not be advisable to be dependent of foreign funds in projects with higher risk and sensibility. Airports and highways of strategic importance, nuclear power plants, border infrastructure are some of the examples where FDI might not be the best option to fund the projects.

Finance from multilateral agencies like the World Bank, JBIC, ADB etc has historically been one of India's most important sources for infrastructure finance. These agencies provide long term finance at a relatively low rate of interests. The Delhi Metro is one of the best examples of such finance. The Bullet train project in India is being funded by the Japan International Cooperation Agency (JICA).

Traditionally the banks have been the most preferred source of finance for any project. However due to the current volatility in the market, a single bank might not be willing to take the risk of financing infrastructure projects. Therefore, Syndicate financing, where two or more banks combine through special purpose vehicles (SPV) to finance large infrastructure projects, is a viable option. This not only helps raise larger amounts of finance but also divides the risk among the syndicating banks.

Infrastructure spending is the right step in the right direction for the economic recovery of the country. The National Pipeline Project will not only develop world class infrastructure in the country but will also help cash flow in the economy and generate employment. All this will ultimately help the GDP growth rate recover and improve the standard of living of the citizens. However, this entire pipeline consisting of 7000 identified projects will require a humongous amount of capital. Raising this capital will be the first hurdle before the government before getting the ball rolling. Every financial intrument have their own pros & cons. The government needs to be cautious before selecting any of these options or mix of options to fund any project.

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