India’s 2015-2016 Budget: A kick-start for infrastructure

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While India’s recently-announced Budget Plan may not have been a ‘big bang’ as some investors expected, many believe it will have a very big impact on the country’s infrastructure sector. Indeed, with this announcement, India’s Government is clearly taking significant steps to demonstrate that it is willing to make big changes in order to deliver on its old promises.

As Arun Jailey, India’s Finance Minister, stood up to deliver the Modi government’s first full-year budget this past weekend, he had good reason to be pleased. Over the past few months, India’s growth has continued to pick up and the macroeconomic trends had become increasingly positive.

What the country needed was not a ‘big bang’ but rather a pragmatic approach to catalyzing growth while continuing to maintain fiscal prudence: a long-term plan that would combine investment, policy reform and improved regulation to deliver the right environment for growth over the coming years and decades.

And that is exactly what the Finance Minister delivered in this year’s budget. In fact, we believe that Mr. Jaitley’s “Growth Oriented” approach – which envisions GDP growth of 8 percent in financial year 2016 and double-digit growth by 2020 – includes a number of much-needed measures that should encourage increased activity and investment in India’s infrastructure sector and, in doing so, help to spread the benefits of growth across the economy.

Focus on infrastructure

Mr. Jaitley’s budget demonstrates that the Modi government is keen to unblock the infrastructure pipeline. In part, he will use public money to do this: recognizing that many projects have been stalled by a lack of private funding, the Budget included US$11 billion in increased commitments through Private Sector Enterprises for infrastructure investment.

More importantly perhaps, the Budget also included a new fiscal framework for the division of taxes between the central and state governments, increasing the allocation towards states by about 10 percentage points. It is expected that states will now be more empowered to spend on infrastructure capacity creation (albeit at the expense of some ‘fiscal headroom’ at the Central Government level).

What was particularly notable in the approach taken by Mr. Jaitley is that it reinforces the ‘One Team’ model for infrastructure that recognizes the importance of both the Central Government and the State Governments who, arguably, are closer to those that need and use the infrastructure. Continuing partnership between the various levels of government in India is an encouraging sign.

Meeting the social agenda

This year’s budget also recognizes the need to take immediate action to achieve some of the government’s larger social platforms such as ‘Power for all’ and ‘Health for all’. For example, the budget includes provisions to help electrify the last remaining

20,000 villages without access to grid connectivity in India by 2020. It also increases central allocations to the health sector by 8 percent (or USD5.3 billion) to support capacity increases and improved access to healthcare.

Education also features in this year's budget with plans announced to upgrade more than 80,000 secondary schools and 75,000 junior and middle schools. And more than 100,000 additional kilometers of roads are also included in the budget in order to provide road access to those rural inhabitants that are currently 'unconnected' to the network.

Unlocking infrastructure investment

While direct investments into infrastructure certainly forms one part of the government's new strategies, the budget also includes some important measures aimed at improving the environment for private infrastructure investment as well.

Most notably, the budget proposes the creation of a 'National Investment in Infrastructure Fund' with an initial annual allocation of USD3.25 billion. The fund will be expected to invest in public sector infrastructure finance companies which, in turn, will be able to leverage their higher credit rating to access domestic and international debt markets. This step should help the sector attract increased investment from foreign pension funds, insurance funds and other institutional investors seeking more secure investments. The fund is expected to increase its annual allocation in future years.

The fresh allocation of USD2.25 billion to roads and USD1.6 billion to railways is also intended to improve liquidity in the system by pushing forward EPC, Cash Contract and Annuity models for the awarding of projects in these sectors.

Blazing a new path with regulatory reform

Recognizing continued complaints from both domestic and foreign investors about the current PPP dispute resolution process, the budget brought forward recommendations for a 'Public Contracts (Resolution of Disputes) Bill' and a 'Regulatory Reform Bill' that would aim to bring greater consistency across the country's various regulators and regulation.

Interestingly, the budget makes note of the need to reboot the PPP framework and suggests that government may need to take on some of the additional risk. This is a prudent message to send; private investors have long been put off by the current risk frameworks which often skew the risks in favor of the government authority.

The budget also included plans for the creation of a 'Bankruptcy Code' which should go a long way towards helping local lenders to better manage their non-performing and stressed assets. Once the recoveries have been sorted out, this step should help bring some very interesting and viable projects to the market for investors.

Some clarity required in the renewable energy sector

While this year's budget reiterates the government's commitment to exponentially increase the installed capacity of renewable energy generation (from 32GW to 175GW by 2022), there continue to be a number of areas that will need to be clarified in order to make this target achievable.

Key issues – such as the need for transformational change in the delivery network, the need for new financing solutions for capacity expansion, land acquisition and the setting of rates – continue to slow progress in achieving a step-change in investment in this sector. Once progress is made in these key areas, however, we expect the renewable energy sector to quickly take off.

Railways back on track

Interestingly, this year's budget did not include a single new train or new project in the rail sector. What it did do, however, is provide a roadmap of investment (to the tune of USD138 billion) for the next five years. Indeed, the document felt more like a private sector strategy document than a public sector budget plan. The budget articulated a series of goals, drivers and 'thrust' areas that would drive investment over the coming years, with increased capital commitments to help achieve those goals.

To finance these commitments (the total capital budget will need to increase by 52 percent or USD16 billion in 2015-2016 alone), the government has created a new financing approach under the banner of Extra Budgetary Resources (Institutional Finance). Under the plan, the government will ring-fence certain projects where funding could be achieved through alternative approaches such as infrastructure bonds, pension funds and insurance funds. This, coupled with the proposed regulatory reforms, should help unlock new funding sources to help achieve India's railway objectives and shows the seriousness of the government's intentions to tap the market for new funding.

A strong push for the infrastructure sector

Overall, this year's budget provides a rather 'big bang' for the infrastructure sector and clearly demonstrates the Modi Government's intention to kick-start infrastructure investment and unblock the pipeline. Indeed, by increasing public spending, creating new infrastructure funds and laying out the foundations for a stronger, more transparent PPP process, the government seems committed to addressing the key challenges that have long been raised by international and domestic investors.

What remains to be seen, however, is how these new policy directions and investment will flow 'downstream' into the respective infrastructure ministries responsible for delivering on the expectations set by the government. At KPMG's network of member firms, we are certainly optimistic.

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