Reforms and Opportunities in the Indian Infrastructure Sector

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India – The Macro Picture

Indian Economy - Strong Fundamentals

GDP

Average Growth 6.0% over the past decade

Forex Reserves

USD 120 billion

With growth drivers in place, the potential for sustained growth remains

Inflation

Dropped from an average of 10% in early 90s to the sub 5.0% level in fiscal 2004

Current Account Position

Deficit of 1.7% of GDP in 1996 to a surplus in fiscal 2004

India: Changing Paradigms

- A VIBRANT DEMOCRACY
- SUSTAINED STRONG PERFORMANCE OF THE SERVICE SECTOR
- RESURGENCE IN THE MANUFACTURING SECTOR
- RAPID INFRASTRUCTURE DEVELOPMENT
- BROADBASED SUPPORT FOR COMPREHENSIVE REFORMS

India: The Opportunities

- The Second Largest Country in terms of Population
- The Fifth Largest Economy in the World (PPP)
- The Seventh Largest in terms of Area
- Amongst the Fastest Growing Economies in the World

Infrastructure Sector Reforms

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Reasons for Slow Development of Infrastructure

- The Lack of Political Will
- The Absence of a Regulatory Structure
- Initial Hesitance to Pay User Charges
- High Interest Rate Regime
- Lack of Sector Familiarity by the Domestic Banks and FIs

The Need for Infrastructure Reforms

- While India's economic performance has been impressive, it has lagged behind other competing economies in terms of the infrastructure quality and availability
- Traditionally, most infrastructure sectors were regarded as "natural" monopolies where a single firm could supply a market at the lowest cost
- However, advances in technology and in economic thinking have shown that competition in many cases is not only feasible but also highly desirable
- The Government of India (GoI) realizes the importance of world-class infrastructure for sustained economic growth
- Given the large resource requirements, GoI has increasingly felt the need to attract Private Sector Participation (PSP)

What Has Changed…

- The Political Will to Develop Infrastructure
- Better Articulation of Policy
- An Emerging Regulatory Structure
- Earmarking of Specific Resources for Leveraging Commercial Investment in Infrastructure
- Greater Investor Confidence
- Availability of Funds from Multilateral Agencies
- Growing Acceptance of User Charges
- A Lower Interest Rate Regime
- A Sustained Reform Process
- Significant Sector Financing by the Domestic Banks and FIs

The Growth of Infrastructure Capital: 1998 - 2003

Sector	Capacity Mar 1998	Capacity Mar 2003	% Increase
Power			
Capacity ('000 MW)	87	109	25.0%
Units Generated (billion KWh)	421	531	26.1%
Oil & Gas			
Refining Capacity	63	117	85.0%
Utilisation Rate	104	94	--
Pipeline (km)	15141	17590	16.2%
Telecom			
Wireline & Mobile Subscribers (million)	22	54	142.4%
Ports (Major Ports)			
Capacity (million tonne)	218	362	66.0%
Traffic Handled (million tonne)	252	295	17.1%
Roads			
Length (million km)	2.5	3.3	31.3%

Source: Ministry of Power, Ministry of Surface Transport, Ministry of Telecom, Ministry of Petroleum & Gas, Ministry of Civil Aviation, Ministry of Shipping

Key Initiatives

- Fiscal benefits
  - 10-12 years tax exemption for infrastructure projects
  - Tax benefits for institutional and retail investors
- Encouragement to Foreign Direct Investment (FDI)
- Development of regulation and model concession agreements
- Increase in the budgetary outlays to the infrastructure sector
- Relaxation of IPO guidelines for infrastructure companies

The Budget: A Continued Emphasis on Reform

- A continuing reform process - Best reflected in the easing of the FDI limits in the Telecom, Insurance and Civil Aviation Sectors
- The Budget aims at maintaining a sustained GDP growth of 7-8%. Infrastructure being one of the key focus areas to drive growth
- The Budget underscores the Government's resolve to removing inadequacies in infrastructure facilities through a mix of policy and fiscal measures
- The need to develop rural infrastructure has been emphasized
- Thrust on the Urban Water Supply Programs
- New Inter-Institutional Group (IIG) has been formed to ensure implementation and speedy loans to infrastructure projects

The Story So Far

- Within Sectors, the pace of reforms has varied significantly, due to select commercial and regulatory issues
- Consequently, progress and opportunities across Sectors differ both in quantitative terms as well as in terms of attractiveness
- While there are still some gray areas, the emergence of a market-linked, yet suitably regulated competitive framework presents a huge opportunity

The Telecom Sector

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Current Status

- Rapid expansion in the sector accompanied by technological change
- Total number of connections grew by 40% in 2003-04 to cross 76 mn by March, 04
- Fixed lines grown by 3%, mobile telephones grown by 160% in the same period
- Tele-density touched 7.02 telephones/1000 people as on 31 March,04

International Comparison of Tele-density (2003)	
Countries	**Tele-density**
Australia	126.18
Bangladesh	1.56
Brazil	42.38
China	42.32
India	7.02*
Indonesia	9.17
Nepal	1.70
Pakistan	4.42
Sri Lanka	9.57
USA	116.43
UK	143.13
Source:ITU, Dec 03 , *India's teledensity as on 31 Mar,04	

The Stepping Stones

- The National Telecom Policy, 1994: aimed at achieving accelerated telecommunications growth and network expansion
- The National Telecom Policy, 1999: a new telecom policy that led to private participation in a significant way
- Calling Party Pays (CPP) Regime, 2003
- The Interconnect Usage Charge (IUC) Regulation 2003: A level playing field in interconnection charges
- Universal Service License
- FDI limit increased from 49% to 74%
- Universal Service Obligation fund set up as separate non-lapsable fund

The Opportunities

- Policy and tariff rationalizations have enhanced the viability of cellular services
- Improved connectivity and opening of long distance inter-state telephony
- CAGR of 100% per annum in the cellular/wireless segment over the next three years
  - 1 million cellular subscribers being added per month
  - Additional spectrum allocated
- The telecom operators have invested USD 9.8 billion in the last three years to capitalise on this growing opportunity
- The Indian telecom market, currently estimated at USD 8.1 billion is expected to reach USD 18 billion by the fiscal 2010 at a CAGR of 12%
- The growth paradigm in India's telecom space would require a capex of USD 20 billion, over the next five years

The Power Sector

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Current Status

- The installed capacity has increased from 1,300 MW in 1947 to 114,000 MW in 2004
- Peak Demand: 84500 MW, Current Supply: 71,700 MW – a 15% Shortfall
- The increase in power supply is not keeping pace with the increase in demand
- Over the last decade, electricity consumption has increased at an average rate of 9-10% p.a. while, supply has increased by only 7%
- The Singular Constraint : The Health of SEBs
- The Singular Detractor : Enron/Dabhol Episode
- The Ray of Hope : The Electricity Act, 2003

The Reforms

- Accelerated Power Development Reform Programme (APDRP): budgeted investments of USD 8.8 billion for renovation, modernisation and upgradation of the sub-transmission and distribution network
- The Electricity Act 2003:
  - Allows Private Sector Participation in Transmission and Distribution (T&D)
  - All State Electricity Boards have to be unbundled into functional entities before September 2004
  - Stipulates that subsidy has to be provided for in the state budget
  - Delicenses the generation of power
- Improvement in public sector efficiency :
  - Existing generating plants
  - Transmission gains
  - Distribution efficiencies
  - Pricing
  - Recoveries : non-technical losses

The Opportunities

- The government's programme "Power for all by 2012" aims to close the demand – generation gap
- Generation freed, clearances required to decrease sharply
- Encouragement for captive power generation and third-party sales
- Direct access to retail consumers due to open access for T&D
- Separation of wires business from supply business
- Open access will allow distributors to source cheaper power
- Tremendous opportunities for private power utilities in the distribution activity
- Accelerated Rural Electrification
- The Electricity Act, 2003 provides a framework for the creation of a pan India energy market
- Required investments are estimated at USD 38 billion over the next 6 years

The Road Sector

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Current Status

- The Indian road network at 3.3 million km, is the third largest in the world:
  - National Highways constitute nearly 2 percent at 58,112 km
  - Rural Roads are 78 percent with 2.65 million km
  - State Highways form the rest
- The roads carry 85 percent of all passenger traffic and 70 percent of freight with nearly 40 percent of the total traffic moving on the national highways
- Nearly 25% of the National and State Highways are Congested
- At less than 1,000 km of paved roads per million people it is:
  - Below the average 10,000 km in industrialised countries, and
  - Below the 3,000-5,000 km in comparable developing economies
- In order to meet the additional requirement, the Government has initiated significant programs through PSP

Notable Initiatives

- Amendment to the National Highways Act, 1956 to facilitate private investment
- The National Highway Development Programme (NHDP)
  - Involves the strengthening and 4/6 laning of approximately 14,253 km of National Highway
  - At an estimated Project Cost of USD 14 Billion, the NHDP is the largest public works program under taken in the Road Sector after WW II
- The Pradhan Mantri Grameen Sadak Yojana (PMGSY)
  - The USD 13 Billion (revised estimates at USD 29 billion) project implemented by the Ministry of Rural Development aims at upgrading 500,000 km of existing rural roads
  - USD 4.3 Billion is expected to be available from cess on diesel
  - The Resource Gap is expected to be bridged by access to Multilateral Funds and raising funds from the Domestic Market
  - Proposals worth USD 2 Billion cleared
- Pradhan Mantri Bharat Jodo Project for the development of 10,000 km of roads connecting the State Capitals with the National Highways

The Opportunities

- BOT - Construction
- Operation & Maintenance
  - The Golden Quadrilateral is due for completion by end of 2004; NSEW by 2007 – 1400 km will be bid out for Operations and Maintenance
  - Current BOT projects
  - State Government Projects
- Buyouts
  - Most of the projects under operations are small to medium sized
  - These projects could provide a low cost and ready entry strategy for foreign companies wishing to test the Indian market
  - Most projects are doing well and offer stable and predictable cash flows that can be leveraged to attain higher returns through efficient financial structuring
- Unsolicited bids
  - Various State Governments have enacted laws that now allow operators to submit unsolicited bids for projects

The Rail Sector

Current Status

- The Indian Railways (IR) is the second largest rail undertaking in the world with a total Length: 63122 Route km
  - Broad Gauge: 45622 Route km
  - Metre Gauge: 14316 Route km
  - Narrow Gauge: 3136 Route km
- The Rail Golden Quadrilateral (GQ) covers 16% of the network, but accounts for 65% of freight traffic and 55% of passenger traffic
- Freight (2003 – 04): 557.4 Million Tonnes
- Passengers (2003 – 04): 5112 Million
- Issues
  - Ageing Infrastructure
  - Declining Budgetary Support
  - A large Permanent Work Force
  - Loss of Share in the Freight Market

The Reforms

- Tariff Rebalancing and Rationalization of Fare and Freight Structures
- The Ministry of Railways has launched the USD 3.3 Billion National Rail Vikas Yojana (NRVY) to strengthen the GQ and to improve Port Connectivity
- Rail Vikas Nigam Ltd (RVNL), an SPV has been created to facilitate PSP in railway projects. 70 projects are open for PSP over the next 12 months
- Private firms have already bagged projects amounting to USD 820 million
- IR has entered into a range of Memorandum of Understanding/Agreements with various State Governments to execute projects on cost sharing/public-private arrangements
- Private-Public Partnerships:
  - Pipavav Railway Corporation (for the development of Sundernagar – Pipavav Broad Gauge Line)
  - Hassan – Mangalore Rail Development Company (for gauge conversion)
  - Kutch Railway Company (for gauge conversion between Palanpur and Gandhidham)
- The Indian Railways have created a USD 4 billon non-lapsable Special Railway Safety Fund (SRSF), to be invested over the next five years

The Opportunities

- The Golden Quadrilateral Program
- The Port Connectivity Program
- Gauge conversion (Metre to Broad)
- Urban Rail Transit - Light/Mass

The Port Sector

Current Status

- India has 160 operable ports along its 6,000km long coastline
  - 12 Major Ports: Account for 75% of the traffic
  - 139 Operable Minor Ports: Account for 25% of the traffic
- In the Ninth Plan (FY97-FY02), the capacity of Major Ports increased by 57% to 344mn te
- The productivity of Indian ports has improved with reduction in average pre-berth detention and lower turnaround time though its still low by international standards
- Cargo Handled
  - Dry and Liquid Bulk constitute 80% of the traffic
  - Containers constitute 20%, and growing at 15% over the last 5 years

The Reforms

- The Port Sector was opened to private participation in FY91 to increase capacity and to introduce modern management practices
- Major Ports have been permitted to form Joint Ventures with Foreign Ports, Minor Ports and Companies
- The Tariff Authority for Major Ports (TAMP) has drafted a new set of guidelines which are likely to be notified by the government thereby providing them with legal sanctity
- A number of State Governments have formed State Maritime Boards to address opportunities in the sector
- Up to 100% FDI under the automatic route permitted
- 10-year Tax Holiday for Investments in Ports
- Corporatisation of major Ports underway
- Ports are permitted to lease out existing assets
  - JNPT
  - Chennai Port
  - Cochin Port
- Greenfield Projects
  - Gujarat Pipavav Port Ltd
  - Adani Port Ltd

The Opportunities

- The sea borne trade is expected to touch 565 million tonnes by 2006-07, at a CAGR of 8 percent
- GoI has identified 26 projects for PSP for Major Ports
- The Development of Private Ports
- The Sagarmala Project
  - To be completed over the next 10 years, the project envisages setting up of new ports, modernisation of the existing ones, and connecting all major ports with the Golden Quadrilateral and the North-South and East-West corridors
  - The total cost is estimated at USD 22 billion
  - The 10th plan has provided USD 516 million for this project
- Services
  - Dredging
    - Monopoly of Dredging Corporation of India (DCI) ends FY 2007
    - The Sagarmala Project
  - Operations

Special Economic Zones

Current Status

- SEZ are special duty-free enclaves designed to promote foreign investments in a range of economic activities, including manufacturing, trading, and financial services
- Units in SEZs enjoy several concessions, including duty waivers on imports, reimbursement of sales taxes paid on domestic purchases, and Income Tax breaks
- Salient features of SEZs in India
  - Import of capital goods and raw materials duty-free without the payment of terminal excise duty
  - Reimbursement of central sales tax paid on domestic purchases. No licence required for imports
  - 100% tax break/holiday for ten years up to 2010
  - 100% foreign ownership and investment automatically cleared in the manufacturing sector
  - Profits allowed to be repatriated freely without any dividend balancing requirement

The Opportunities

- The GoI recognizes the importance of SEZs as engines to boost manufacturing, exports and employment.
- Bill to regulate SEZs is likely to be introduced shortly
- 100% Foreign Direct Investment in manufacturing, sector allowed through automatic route barring a few sectors
- Exemption from industrial licensing requirement for items reserved for SSI sector
- Job work on behalf of domestic exporters for direct export allowed
- In-principle approval has been granted to 13 SEZs. Currently the Navi Mumbai SEZ (NMSEZ) is under construction
- The Revenues of operating SEZs has been growing sharply – from USD 1.8 million in 2001 to USD 2.2 million in 2003

The Airport Sector

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Current Status

- India has 450 airports that are managed by several government agencies like the defence services, the state governments, the Airports Authority of India (AAI) and the private sector
- The plan outlay for the sector has remained almost constant over the past four years
- The passenger traffic for the fiscal 2003-04:
  - Indira Gandhi International Airport: 10.4 million (a growth of 13%)
  - Mumbai International Airport: 13.2 million (a growth of 8.3%)
- The absence of a Hub Airport

The Reforms

- The AAI was formed in 1995 by merging the International Airports Authority of India and National Airports Authority to accelerate the integrated development of airport facilities
- The Airports Authority of India Amendment Bill 2003 (AAIAB) provides the legal framework for private investment in new and existing airports. The Main Provisions of AAIB:
  - Private players in a joint venture with AAI can hold upto 90% equity in metro and 50% in non-metro airports
  - Maximum 49% foreign holding
  - Concession Agreement: 30 years. Provision for automatic renewal for another 30 years
  - Provision for the levy of an airport development fee on passengers to be used to upgrade or construct new airports

The Opportunities

- Air Travel more affordable
  - Scrapping of the 15% inland air travel tax and foreign air travel tax of Rs.500
  - Halving of the excise duty on aviation fuel to eight percent
  - Reduced landing charges by 15% for domestic flights
  - Aircrafts with capacity below 80 seats exempt from landing charges
  - 8 low-cost airlines on the anvil
- Favourable growth prospects for the Indian Economy to propel greater travel
  - Resurgent manufacturing and service sectors
  - Tourism
  - Connectivity of rural and urban agglomerations
  - Globalization
- State Governments are willing to enter into frameworks for the development of airport infrastructure in the State
- There are six airport projects in the pipeline, including two greenfield projects; the Concession Agreement with the Bangalore International Airport has been signed
- GoI estimates that the total investment required by the airport sector is approx USD 2 billion over a 5 year time frame

The Urban Infrastructure Sector

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Current Status

- Urban area's account for 28% of the country's population
- There exist critical deficiencies in transportation system, water supply and sanitation
- Government's efforts to upgrade infrastructure will remain insufficient
- Amendments to the Constitution provide a framework for local bodies to induct PSPs to provide a range of services
- A number of projects are now being implemented on a PPP basis in the following areas:
  - Transport
  - Water
  - Sanitation
  - Environmental Infrastructure
  - Solid Waste Management

The Reforms

- The Urban Reform Incentive Fund (URIF): with an initial allocation of USD109 million would be set up to provide reform linked assistance to the states
  - Revision of municipal laws in line with model legislation prepared by the Ministry of Urban Development and Poverty Alleviation
  - Initiation of public private partnership in the provision of civic services
- The City Challenge Fund (CCF) set up as an incentive based facility that shall support cities to fund transitional costs of moving towards sustainable and creditworthy institutional systems of municipal management and service delivery
- The Pooled Finance Development Scheme set up to provide credit enhancement to assist local bodies to access market borrowings on a creditworthy basis
- Permission to municipal bodies to float tax-free bonds to finance the development of urban infrastructure. The bonds shall carry tax-free interest
- State Governments actively encouraging PSP in the sector

The Opportunities

- Transport
  - Mumbai Urban Transport Project (MUTP)
    - The total estimated cost of the project is USD 1 billion, the World Bank has sanctioned a loan for USD 610 million
    - Road Transport Component: USD 233 million
    - Rail Transport Component: USD 771 million
  - Urban Transport Projects for Other Metropolitan and Category 'A' Cities
- Solid Waste Management
  - One of the most neglected areas of urban infrastructure – some local bodies are now making concerted efforts to address this issue
    - Hyderabad
    - Delhi
- Water
  - Most households in India depend on municipal water supply for their daily needs
  - Only 41% of Indian households have exclusive access to their own source of water
  - The local bodies have to subsidise the price of water
  - Municipal bodies are accessing capital markets to install infrastructure
    - Tirupur
    - Ahmedabad
  - Conservative estimates place the size of the emerging water market in India at USD 2 billion

The Housing Sector

Current Status

- Housing sector can be bifurcated into organised and unorganised segments, with the unorganised segment estimated to account for over 75 per cent of the housing units constructed
- Shortage of housing of over 20 million dwelling units in both rural and urban areas
- During the past 5 years, the housing sector, helped by a growing housing finance industry, has expanded significantly
- The value of new investment in the sector is estimated at USD 30 billion
- The market is estimated to grow by 6-8 per cent in the next few years

The Reforms

- The government has stressed on the rural housing sector and has raised the allocation for Indira Awas Yojana by UDS 120 million to USD 500 million.
- Reserve Bank of India (RBI) will revise the norms of repayment of rural housing loans by banks so that installments coincide with crop cycles
- Tax exemption on interest on housing loans at Rs 150,000 (USD 3300 per year)
- FDI upto 100% is permitted with prior Government approval in integrated townships and settlements
- The National Housing Bank (Amendment) Act, 2000 envisages a speedier method of recovery of dues from the defaulting borrowers of housing finance institutions (HFIs), through recovery officers
- Reduction in risk weight for Non Banking Finance Companies(NBFC) to 50% from 100%
  - Increased NBFCs exposure to housing sector due to higher quantum of capital
- Accommodative Monetary Policy followed by the RBI has resulted in declining interest rates on housing loans. Banks and NBFCs have seen a 30% increase in disbursal in fiscal 2004

The Opportunities

- Investment required to meet the demand gap is estimated at USD 88 billion
- The Government has set a target of 250,000 rural housing units per year
- Lower Interest rates encouraging home ownership
- There exist opportunities for private companies in
  - Construction
  - Project Rating
  - Secondary Mortgage Markets
  - Consultancy

Summing Up …

- There has been a Convergence of public policy and public opinion regarding the relevance to PSP in the development of public infrastructure - to propel growth…
- … that has enabled the resolution of a number of long pending sector specific regulatory and commercial issues
- Over the years, the Government has gone through a significant learning curve in terms of the requisite regulatory and legislative framework – and what is practically doable
- With several legislative aspects addressed coupled with an enabling macroeconomic framework, infrastructure spend is expected to touch US$ 51 billion, with the private sector improving its share

A large Demand – Supply Gap exists … the Indian middle class has begun to appreciate the benefits of quality services –and is willing to pay their economic price

Thank You