

“Investing in Infrastructure: Key to Economic Growth”

Introduction

Role of Infrastructure in Growth and Poverty Reduction

As you know, India's performance in recent years has been among the best in the world. The reforms initiated since the early 1990s have unshackled the economy. The long-term trend rate of growth has steadily increased from an average of 3.5% a year between the 1950s and 1970s, to around 7% to 8% in recent years. According to the Government's latest estimates, GDP grew by 7.5% in 2004-2005, and is expected to grow by 8% in 2005-2006. The prowess of India's IT and IT-enabled services, biotechnology, pharmaceuticals, and various manufacturing segments is being recognized the world over. Its macro-fundamentals are sound and foreign exchange reserves are comfortable at around \$139 billion.

This rapid growth has led to a decline in the incidence of poverty—from 36% in 1993-1994 to 26% in 1999-2000. The number of people in poverty came down from 320 million to 260 million during this period, and has undoubtedly declined further since the last official estimates became available.

Despite these improvements, hundreds of millions of India's people remain poor. Given the current pace and pattern of growth, India will not reach many of the non-income Millennium Development Goals (MDGs) for maternal mortality rates, infant mortality rates, or gender parity in secondary enrollment ratios within the stipulated timeframe of 2015. Since India accounts for nearly 16% of world population, this would imply that the world as a whole will fall short of attaining the MDGs.

Infrastructure development will play a crucial role in helping India sustain high growth rates and more evenly spread the benefits of growth among its people. The critical role of infrastructure in facilitating growth is widely recognized, and well borne out by cross-country experience. For example, the miraculous transformations of Japan, Hong Kong, the Republic of Korea, Singapore, Taipei, China, Thailand, Malaysia, and the People's Republic of China were preceded and reinforced by substantial investments in physical and social infrastructure. By promoting connectivity of producers and markets, lowering transactions costs, and providing people with access to important services like education and health care, a reliable infrastructure network lays the foundation for a future of sustainable economic growth. Extending roads, schools, health clinics, utilities and other services to those populations who need it most will make the process of growth more inclusive and bolster the fight against poverty.

Bottlenecks constraining India's growth

Already, however, the accumulated economic and social costs of power shortages, bad roads, inadequate capacity in ports, poor water and sanitation facilities, and unreliable communications systems in India are huge.

The latest Economic Survey of India (2005-2006) estimates that at peak levels and of 8% at non-peak levels points Rupees (\$3.4 billion USD) of foregone generation capacity of around 3 trillion Rupees or \$68 billion (assuming

that a power shortage of 12% is equivalent to around 150 billion capacity, or an approximate GDP loss gas supply multiplier of 20)!

and private investors, and further constrain the process of growth. Indian ports have a vessel turn-around time of 3 to 5 days, compared to only 4 to 6 hours in Singapore and Hong Kong. Most large Indian cities are over-stretched and congested due to fast growth, and are suffering from scarce water and power supplies. The national highways account for 2% of total road length, but 40% of total traffic. Moreover, of the total length of national highways, only 12% is 4-lane, while over one-third is single lane. By adding significantly to the cost of doing business, infrastructure bottlenecks also deter foreign

Government's Response

Fortunately, the Government of India is fully aware of these challenges, and has been working to address them. For example, the \$39 billion program of Bharat Nirman will significantly improve the lives of millions of poor people by connecting villages and providing housing, clean drinking water, electricity and telephone service across rural India. The National Horticulture Mission is upgrading irrigation infrastructure, expanding the rural roads network, and strengthening agricultural storage and marketing infrastructure. As of November 30, 2005, more than 6,000 kilometers of roads have been constructed under the National Highway Development Program, and over 6,000 more are under construction. Through the \$27 billion National Urban Renewal Mission, 63 cities will benefit from better housing, water and sanitation—and ultimately, better delivery of other basic services such as health, education, and social security.

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These mega programs are essential for maintaining steady rates of growth and poverty reduction. But financing them without adding to the fiscal burden is clearly a major challenge.

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For most of the 20th century, infrastructure investment was financed publicly across the world. Since the mid-1980s however, rising costs, the complexities of creating and maintaining infrastructure projects, increasing fiscal pressures, and competing demands on public resources have forced governments to look to the private sector for financing and expertise.

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India is no exception. Since the crisis of 1991 and the launch of economic reforms, the Government of India has been trying to rationalize the role of the public sector, and to increase the participation of the private sector in critical areas such as infrastructure. Considerable progress has been made in attracting private capital in sectors such as telecommunications, ports, power, and roads. But the response so far has fallen short of expectations for various valid reasons—financial, technical, and economic.

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and private parties. An infrastructure project may be of great social benefit, but it may be too risky from the perspective of private investors. The creation of roads, bridges, power lines and drainage systems involves huge sunk costs. These assets are indivisible public goods, and virtually non-tradable in most cases. The setting and collection of user fees is often politicized, and this adds to the risk perceived by investors. Financial and legal risks can arise from non-recourse financing, complex payment mechanisms and other uncertainties.

I am pleased to note that the Government is responding to these issues. For example, the provision of viability gap funding and the establishment of the India Infrastructure Finance Company Limited (IIFCL) should go along with a plan for attracting private investment again in India's ambitious programs for national highways, railway freight corridors, power generation and transmission, and urban infrastructure.

In addition, the Government is promoting public-private partnerships in highway development on a Build-Operate-Transfer basis. The Model Concession Agreement (MCA) sets out a precise policy and regulatory framework to reduce uncertainties, and apportion risks and rewards between public and private partners. The model agreement is expected to give a boost to private sector participation in road projects under the National Highway Development Program. Similar agreements are also being developed in the port and airport sectors to facilitate private participation.

Electricity Act 2003 – a bold step towards redressing the fundamental distortions that have long plagued the Indian power sector. The Act combines incentives for private participation with safeguards to protect consumer interests. thirteen independent power projects of more than 5000 MW (amounting to \$4.1 billion) have attained financial closure, and another 10 projects with a total capacity of more than 11,000 MW are currently under consideration.

Other innovative approaches are also being considered, such as a proposal to fund the modernization programs of the Mumbai and Delhi airports by loans in perpetuity. A similar financing arrangement was quite successful in raising funds for the Euro Tunnel. Under such an arrangement, developers repay only the interest (at a high rate), and do not have to service the principal of the debt they raise. By lowering the financial burden, such approaches may elicit an encouraging response.

Role to be played by ADB

As a regional institution focused on poverty reduction, ADB is committed to supporting the Government's efforts to promote sustainable, inclusive economic growth. India is one of ADB's founding member countries, and the third largest shareholder among its regional members. In line with the Government's priorities, India has recently strengthened its operations in agriculture and rural development, and shifted focus to poorer states and less developed regions to help reduce disparities and achieve the MDGs.

The bulk of our ongoing operations in India, as well as the proposed program for 2006–2008, remain focused on the three core areas of transport, urban, and energy infrastructure. In transport, ADB provided a series of loans to assist with the first two phases of the National Highway Development Program. Asian Development Bank is now working with the National Highway Authority of India (NHAI) to see how best it can help with the subsequent phases while attracting private participation and investment on a Build-Operate-Transfer basis. We are assisting with a rural road project covering Chhattisgarh and Madhya Pradesh, and will soon move forward on a second such project for Assam, Orissa, and West Bengal. We are also assisting Madhya Pradesh and Chhattisgarh in upgrading their weak road networks, and similar projects are planned for Uttaranchal, northeastern state, Jammu and Kashmir, and Jharkand.

In the energy sector, ADB is working with the Power Grid Corporation to strengthen the national transmission grid, and with central power utilities to help increase hydropower capacity. Our state power sector loans focus on upgrading transmission, distribution, rural electrification, and capacity building of power sector institutions. A specific aim of this work is reducing system losses and improving collection of bills as required by the Electricity Act 2003. ADB's programmed assistance for the North Eastern region, Madhya Pradesh and West Bengal will complement that already underway in Assam, Gujarat, and Madhya Pradesh.

Finally, our ongoing urban sector operations in Gujarat, Karnataka, Madhya Pradesh, Rajasthan, and West Bengal combine infrastructure development (primarily water, sanitation, and waste management) with targeted poverty reduction components and a strong focus on municipal reforms and capacity building. The 2006–2008 program will continue with similar projects to help upgrade the infrastructure of selected cities in the states of the north east, Jammu and Kashmir, Rajasthan, and Uttaranchal. We will also assist the Government in implementing the National Urban Renewal Mission.

In addition to supporting governments in such efforts, ADB extends support for private sector projects that have a clear development impact. With operations in both sectors, ADB is uniquely positioned to leverage private funds for large investment needs, and to promote partnerships between private and public entities. Over the last year, we have been improving our financial products to better meet our client countries' development needs, such as flexible financing solutions to support public-private partnerships. Apart from traditional lending modalities (LIBOR plus a spread), we will now offer non-recourse lending to public agencies provided certain basic financial conditions are met.

With the launch of ADB's rupee-denominated bond issue in February 2004, India became the first developing member country to access ADB local currency lending operations. Several borrowers in India's infrastructure and financial sectors have indicated a desire to borrow long-term rupees from ADB, and we will explore the scope of expanding local currency lending in consultation with the Government. Given the complexities inherent in large infrastructure investments, the participation of the private sector will naturally be a learning process, and will take time.

There is no single blue-print or approach. However, involvement of external agencies such as ADB can reinforce the initiatives being taken by the Government, and help to leverage additional private investment.

Conclusion

The noted Indian economist Dr. V.K.R. V. Rao said more than two decades ago, “The link between infrastructure and economic development is not a once and for all affair. It is a continuous process; and progress in development has to be preceded, accompanied, and followed by progress in infrastructure, if we are to fulfill our declared objectives of generating a self-accelerating process of economic development.”

India is on the right track. the public and private sectors, working in partnership and in collaboration with development agencies, will be able to bring about significant and sustainable improvements in India’s infrastructure, which will also help the overall process of growth. Growth is the best antidote to poverty, and we are pleased to be a partner to India in this worthy endeavor.

