Chapter IV

Concluding Remarks and Policy Suggestions

The transport sector comprising the railways, roads, ports and civil aviation, has been one of the principal areas of State intervention in India. Given the transport sector's fundamental contribution to economic growth and social welfare, State intervention was perceived to be necessary, as in the case of many other infrastructure sectors, because of the market failure hypotheses, high risk perception emanating from long gestation periods, irregular revenue flows, higher average debt-equity ratio, and economies of scale as well as substantial sunk costs reflected in the high costs of entry and exit, in turn, leading to (natural) monopolistic tendencies/ practices. Public Sector ownership, management and financing of the transport sector in India, however, suffers from several forms of inefficiencies and has been found to be unresponsive to user demand. Further, services are usually priced below costs which impedes the generation of adequate internal surpluses, in turn, leading to excessive dependence on budgetary support. Moreover, in recent times, (i) contemporary cost curves do not justify the natural monopoly of State and (ii) technological developments have allowed unbundling and competition in many infrastructure services, once viewed as the natural monopoly of State.

Furthermore, the on-going structural reform process in India, initiated in the early nineties, has cast a new dimension to the overall framework for the financing of transport infrastructure and services. Some of the major elements of the reform process are to bring about an orderly correction of fiscal imbalances, develop and strengthen financial institutions and capital markets and (further) liberalise the economy with a view to encouraging private initiative and competition. In the transport sector, this has translated, *inter-alia*, into encouraging public sector entities to maximize internal resource generation in order to finance future expansion programs without having to depend (excessively) on budgetary support.

Given the tapering off of the conventional sources of funds to finance new investment as well as for the maintenance of the transport system, there is an imperative need to assess and access alternatives sources that are emerging in the context of the changing policy and operating environment.

In more general terms, much of the debate about funding mechanism for transport has centered on:

i. a limited but direct role for the State
ii. pricing policies for transport infrastructure and services
iii. the attraction and use of private capital
iv. Government intervention through regulation, financial incentives and a redefined role for public-private partnerships.

Policy Suggestions of the Study

(A) From the point of view of an analysis of the resource gap being a reflection of the inefficiency of service delivery from existing transport infrastructural facilities provided mostly by the public sector within an inadequate policy framework and the recognition that the public sector has a relevant, explicit but focussed role to play in transport infrastructure and service provision, the following observations are in order:

1. Pricing and cost recovery policies in the past have often not taken account of the fiscal effects and the cost of public funds. There have, thus, been major adverse effects of distorted pricing on resource allocation, operational and managerial standards of infrastructure services and the environment Thus, setting user charges to economically efficient levels should be an important element of an infrastructure financing strategy. This has to be true not only with respect to services provided by the railways and road transport (the major modes) but also in regard to roads in which case though user taxes do represent genuine user prices to a large extent, many governments have never seen it fit to set these taxes in accordance with accepted public utility pricing principles.

2. Besides an appropriate tariff strategy, efficiency enhancement strategies to result in better utilisation of existing infrastructure and services is required to be in place to set public sector organisations like the Indian Railways and State Road Transport Corporations on a long-term growth path.

3. A financing plan based on efficient prices that also provides for equitable coverage would almost always require subsidies to cover total costs. The traditional method of cross-subsidisation made possible by a mark-up over marginal costs must be abandoned in favour of explicit subsidies. In the case of the railways as well as public sector road transport services, there is a need for systematic pruning of those subsidised services that do not reach the target groups.

4. Moreover, the strategy should be one that alters direction of the use of the system of user charges which is currently devoted mostly to (at least supposed to) funding investment to a system that emphasises maintenance and also controls levels of service usage. This is especially required for road (highway) infrastructure which is most complex in terms of high network implications and accordingly implies a complex maintenance function which requires an effective maintenance strategy. A strategy of earmarking for the roads sector is recommended since the most attractive feature of such a scheme is to link the volume and quality of services (as reflected by operating costs) and the user charges (willingness to pay) with a view to ensure adequate allocation of resources to a low profile economic activity with particularly high rates of return. A basic pre-requisite would be an efficient Road administration under a Road Board which can pursue a genuine purchasing agency approach towards an efficient means of road provision and maintenance. By doing so, the Govt. would be promoting the longer-term process of institutional development.

The above observations, thus, point out the need for a thorough – going reform of policy relating to existing facilities.

(B) From the perspective of additional resource mobilisation to take care of the genuine resource gap and keeping in line with the growing belief in the past two decades or so that the private sector has an increasingly important role to play in the creation of wealth given that the incentive effects of private ownership are important, the following prescriptions are important:

1. Though it is widely recognised that the public sector should retain an important role in infrastructure finance and in the provision of infrastructure services, economic efficiency usually does not require a particular form of intervention. In particular, public ownership, operation and direct financing of infrastructure is often not necessary. Accordingly, in funding infrastructural deficits, it is desirable to draw on market-based financing as much as possible, keeping in view sustainable/prudential norms. These entities can rely on their stable and longer-term revenue profile in issuing debt securities, especially ling-term debt instruments. Such debt instruments helps set important benchmarks for the longer and of the debt market and provide attractive opportunities for contractual saving institutions. This objective may be met by devolving investment responsibilities to autonomous agencies, which are better positioned to gauge users' investment priorities.

2. The objective may also be met by turning select investment responsibilities to the private sector under public guidelines, support and regulation. In the sphere of urban transit, competition for the market (via franchising/ contracting) rather than competition in the market that needs to be encouraged since that framework appears to be the primary cause of increased efficiency among, for example, bus operators in areas where such deregulatory measures have been attempted.

3. As user charges become more relevant and sophisticated, it should be easy to promote public-private partnerships which could ultimately depend on user charges alone. To serve as prototypes, merger of revenues from, say, tolling with taxes should provide a secure revenue base which could open up access to new sources of non-conventional funding such as the capital market, external funding, etc. The experience of both developed and developing countries illustrates the requirement of a close relationship between the need and the desire to develop and tap capital and debt markets (domestic and to a lesser extent, international). This process is still very much in its nascent stage in India and should be encouraged by ensuring a healthy balance between investor and user concerns within the framework of an appropriate regulatory framework

4. Given the experience in developing countries, government guarantees can be expected to efficiently support private infrastructure as an interim measure while the reform process is being set in motion to allow the market to handle the relevant risks. But the Government must consider the expected value of commitments in issuing guarantees. Such valuation of guarantees and other contingent liabilities help in comparing guarantees with cash subsidies. Essentially, valuation enables decisions to be made on the basis of real rather than apparent costs and benefits.

5. The financing mechanism chosen for infrastructure support should encourage greater domestic savings for investment rather than merely divert resources from other investments and the financial saving of the household sector is crucial for additional resource generation for transport financing..

6. The banking sector is a major source of financial savings of the households in the country. The traditional model reveals that the commercial banking sector's involvement in transport sector financing has been almost exclusively limited to loans given to transport operators.

But recoveries being low, flows have been limited. In the presence of an efficient recovery mechanism, the flow of funds from the banks is likely to improve considerably.

7. Given the strength of adequate funding available with the banking system and the inherent efficient credit delivery and recovery mechanisms of NBFCs especially in regard to truck financing, commercial banks themselves should play the role of "Wholesale financing/banking" while the NBFCs should play the role of "retail financing/banking".

8. Financing agencies should (over a period of time) insist on viability of operations either as a firm or as an association/evaporative with a viable fleet and requisite infrastructure as a pre-requisite for lending to truck operators.

9. Financial innovations like take-out financing should be encouraged in the context of transport project financing.

10. Contractual savings form one-third of the financial savings of the households in India. Pre-empted use of these funds by the Government (through requirements to invest in Government securities) has been a major impediment to the development of contractual savings as a source of long-term finance. There is a definite need to liberalize investment norms of contractual savings instruments. While such a liberalization of norms represents the sources side from the flow of funds perspective, the demand for such funds needs to be created through a well-planned programme of disinvestment of public sector (especially infrastructure) entities with a view to promote private participation in infrastructure, to reduce budgetary and management obligation and to promote competition. Such a supply (of) and demand (for) funds can contribute to development of domestic capital market.