Business Standard

Subir Gokarn: The NIF option

A National Investment Fund may provide the solution to the infrastructure mess

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Over the past few months, I have written several columns about the chronic and intensifying problems in infrastructure. To my mind, two issues are of particular concern. First, there is a severe imbalance between investments across sectors, which lowers the productivity of each investment. Infrastructure is essentially a network phenomenon, a chain, which is only as strong as its weakest link. Second, public-private partnership (PPP) may have been a promising strategy in theory, but it is now proving to be financially unviable. The ability of the companies in the business to mobilise even a fraction of the total resources needed from financial institutions and capital markets has virtually disappeared.

Any prospect of an acceleration in growth critically rests on infrastructure investment across a range of sectors. Power plants without coal linkages or ports without rail and road access are not going to cut it. But such large and synchronised investments are not within the capability of the PPP framework in its current state. So is there a solution in sight?

In the common minimum programme laid out by the United Progressive Alliance government in 2004, there was a proposal for a National Investment Fund (NIF). Essentially, this involved pooling the resources mobilised through disinvestment into a fund, which would then invest it into various social priorities that the coalition partners would agree upon. Of course, as we know, this proposal was stillborn. A structure was actually set up, but did not become operational in any meaningful way. Notwithstanding its inability to get off the ground then, I believe it was a good idea and, if properly structured, does provide a solution to the problems identified above.

Three aspects of such a framework are key to its success: investment strategy, financing and governance. On strategy, as discredited and archaic a term "planning" may have become, its utility needs to be appreciated. As I said earlier, the entire infrastructure system of an economy performs like a network. It works efficiently only when all the components of the network match. While it may be relatively easy to draw up a blueprint of interlinked projects with balanced capacities, executing them so that the balance is maintained is clearly a huge challenge. This requires co-ordination between executing agencies and conflict-resolving mechanisms that work quickly. The record would suggest very strongly that our current mechanisms have not worked.

In effect, we need an integration of planning, monitoring and conflict resolution functions. The institutional framework within which this integration takes place is important and needs to be carefully designed. All of these functions currently exist within government; any new design needs to be based on a clear appreciation of why they didn't work to the desired level of effectiveness.

From the perspective of the NIF, though, the strategic dimension provides a foundation for the other two aspects. Strategy could be internalised into the structure, thus making it into a National Infrastructure Commission, for instance. Or it could be an external mandate to a more narrowly focused mechanism, combining finance and governance.

Where do the funds come from? Some must come from standard budgetary provisions. But the original concept of the fund is really what makes it meaningful. Disinvestment realisations are clearly an important potential resource. The political economy of disinvestment has been challenging and the opportunities and valuations have changed significantly over the past decade. However, there are still substantial prospects, particularly if the government is willing to give up its majority stake in the more successful public enterprises. This will, of course, entail a restructuring of the employment contracts of management and workers in these companies, perhaps done through grandfathering.

A huge potential source of funds is what I would call a balance sheet substitution. When the government transfers assets that it conventionally owns to the private sector, it is reasonable to expect that the proceeds be used to create other, new assets. While the original concept of the NIF was limited to disinvestment realisations, which also fall into this category, the far bigger opportunity lies in - well - land, mining rights and spectrum.

Both actual realisations from, for example, the 3G auction in 2010 and notional valuations suggest that the resource potential from a fairly valued and well-managed asset transfer is enormous and could significantly enhance the economy's capacity to invest in critical infrastructure. The first task for an NIF will be to make a realistic assessment of the size of the potential resource base and the level of difficulty - legal, social and political - in being able to tap into it. Will it generate a trillion dollars over five years? Half that number? One-tenth? This is all in the realm of speculation now, so we need some credible answers before a strategy can be developed.

Then there is the all-important dimension of governance. The basic reason why transactions involving land, mining rights and spectrum went the way they did over the past few years is, I believe, the absence of an appropriate governance framework. At its core, any framework that deals with these issues must take into account the time horizon over which these transfers have an economic impact. Since this is far beyond the term of any government, perhaps even more, the governance of the NIF needs to have much wider representation, going beyond the government, to opposition parties at the very least. This may sound like the kiss of death, but the alternative is the misuse of discretion, charges of corruption and, ultimately, the inability to sustain. This is hardly a recipe for the extra-long-term commitments that infrastructure projects typically involve.

In essence, a well-designed and well-governed NIF could help the economy achieve what it has struggled with for the past two decades: narrow the gap between infrastructure demand and supply. It cannot be an exclusive funder; nor should we forget that the public sector's record of project implementation hasn't been the best. But the lesson of the last decade on this issue is: just because the public sector cannot do something doesn't mean the private sector can.

It isn't the core concept of PPP that needs to be rejected; it is a redefinition of the roles and responsibilities of each partner. An NIF can, with a holistic strategy, adequate funding and credible governance, play a catalytic role in this process and, ultimately, in solving the infrastructure mess.

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