Asset Monetisation for Infrastructural Investment: An illogical plan*

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Announced with much fanfare as an innovative means of financing greenfield infrastructural projects, the National Democratic Alliance government's asset monetisation plan raises a host of concerns. It seems predicated on undervaluing potential returns over a longish period to make the exercise attractive enough for the private sector to bite. It can also involve collateral effects that adversely affect sections like consumers and workers, whose representatives were not adequately consulted with when formulating the plan.

An asset monetisation plan, announ-ced in the budget, has now been fully unveiled, with a detailed listing of assets that are to be transferred for finite periods to private investors for an upfront lump sum or staggered fee. The list includes assets ranging from roads, ports, airports and railway track and stations, through fuel pipelines, telecom towers, optical fibre cabling, warehouses, and stadia. Copied from an Australian playbook, the programme is expected to help mobilise a sum of `6 lakh crore over a four-year period, by giving up whatever returns the government had expected to earn from those "brownfield" or already existing and functioning assets during the years it rests with the private investor. The investor monetising the assets would, during those years, have the right to whatever returns the asset yields. Those returns would come through receipts from use of assets, either as it is or in a refurbished condition, over a specified period, at the end of which the asset returns to the government. In an alternative model, investors buy units in an infrastructure investment trust (InvIT), which acquires the assets and has it managed to extract the returns that are then paid out to the investors. The promoters of the InvIT would have skin in the game to ensure that retail or institutional investors are protected, at least partially.

Since the government is giving up the returns it would earn during the years the assets rest in the hands of private investor, it is expected that it would, at the minimum, be paid the net present value of those returns calculated using an appropriate discount rate, linked presumably to market interest rates. This sets some kind of a reservation price, while the actual receipts from monetisation would be determined through an auction in which investors (numbering, hopefully, more than one) would place their bids and the best bid is accepted, depending on the value and technical qualifications of the bidder.

It should be clear that the private investor must believe that the asset can, either through better management or a combination of improved management and additional investment, yield considerably more than the government expects to earn. That extra sum should be enough to cover any additional investment costs over the duration of the lease of assets, pay for the effort of managing the asset, and promise a return that is attractive enough to take on the risk of entering into the arrangement. In sum, the scheme is predicated on the private investors expecting to earn much more than the government does by operating the assets for the period during which they are taken on lease.

One source from which such a differential may arise is government mismanagement of the asset and failure to undertake any required investments in maintenance, renovation, and modernisation. If that is the reason, the case is not to monetise the asset to get an upfront lower sum than the potentially possible profile of returns warrants, but to address the government's failure. Doing that could generate revenues that would cover the interest charge on low-cost borrowing to finance investment and leave a surplus in the hands of the government every year. So, unless the argument is that the government can never be competent or as capable as the private sector, the scheme of asset monetisation is not warranted. There are enough instances of efficiently operating public enterprises and, in any case, there are a whole host of areas such as defence, for example, that cannot be privatised because the government is incompetent. The task is to ensure that the government is competent.

If differential capability or competence is not the issue, one or more of a set of conditions must hold if the private sector expectations of earning higher returns than the government are to be realised. Many of these have adverse collateral implications which question the wisdom of the asset monetisation plan. Thus, one way to ensure private returns higher than what the government sees itself capable of garnering is to give the private investor greater flexibility and freedom in pricing than the government had. This can be a problem, especially in infrastructural services that are sensitive such as the railways or urban transport. It could result in hikes in tariffs or user charges that affect consumers adversely. This would be particularly true in sectors where asset transfer creates private monopolies. As Rod Sims, Chair of the Competition and Consumer Commission in Australia, from where the asset monetisation idea has partly been imported, noted recently:

Privatising assets without allowing for competition or regulation creates private monopolies that raise prices, reduce efficiency and harm the economy.1

Moreover, the assets listed include some where the current revenue stream is limited because of likely exclusion of citizens from services that are essential. In public–private partnerships where the intent is to have the private sector undertake service provision for whatever reason, the problem can be addressed with mechanisms like viability gap funding that helps keep tariffs low. But that involves funds flowing out from rather than into the budget, which is precluded in an asset monetisation exercise.

A second fallout that could be controversial is for the private sector to cut costs to maximise returns in ways that are unacceptable, especially to workers. Since public sector employment often provides the best conditions in terms of wages, benefits and intensity of work, the consequence of monetisation may be retrenchment of "surplus" labour, wage reduction and/or curtailed social security benefits. This is a possibility unless the concession contract explicitly precludes such action. As of now, there is no indication that such guarantees are being sought. And if they are, private interest may wane.

A third adverse fallout could be a tendency for private operators to garner expected returns by cutting corners when it comes to ensuring the quality of infrastructural services. To prevent that, monetisation may require regulatory frameworks in multiple sectors that specify performance indicators, monitor quality and penalise violations. India's telecom sector experience, even before the expected reduction in the number of players to a duopoly, is an example. Problems such as call drops and low

broadband speeds resulting from inadequate investment in requisite infrastructure while increasing the subscriber base of service providers to enhance revenues are common. The sector also illustrated the difficulties involved in putting in place a working regulatory system.

There is a way in which this tendency to cut corners to maximise returns can affect even the government adversely. Since the successful private sector bidder in a monetisation exercise commits to manage the assets for a specified period, say 20 years, as time passes, the incentive to spend on maintenance or invest in renovation of the asset would decline. This could result in a deterioration in asset quality by the time it is restored to the government and necessitates significant investment on the part of the latter if it wants to keep the asset in use or put it through another round of monetisation. Since that outgo is unlikely to be taken account of when the profile of future net incomes is defined to compute present value, the asset could be undervalued or underpriced.

In fact, the possibility that the monetisation exercise may involve assets being handed over to the private sector at lower than warranted values also arises because of the eagerness of the government to mobilise "non-debt capital receipts" to shore up its expenditure without widening the fiscal deficit. In the past, disinvestment of equity, strategic sale or outright privatisation were the principal means to mobilise such non-debt capital receipts. However, over the last few years, barring a few striking exceptions, the government has not been able to meet its targets for receipts from disinvestment and privatisation, with the realised sums most often falling hugely short of that budgeted. It is to supplement this flailing disinvestment effort that past experiments with piecemeal asset monetisation have been upgra-ded to an "asset monetisation to finance new infrastructure" strategy. This makes success with the asset monetisation thrust crucial. In its desperation to garner resources, the government will be under pressure to make the assets on offer attractive for private investors by setting the expected receipts from individual assets low. Since there is no foolproof way in which returns from existing assets over the next 20–30 years can be projected, making adjustments to keep valuations low may not be all too difficult. And since ballpark figures of expected upfront payments have been calculated to arrive at the "`6 lakh crore over four years" figure, they might be known to bidders, and the actual sale prices are unlikely to be very much higher.

In sum, monetisation, while advocated as a means to mobilise resources to finance greenfield infrastructural projects included in the National Infrastructure Pipeline (NIP), could turn out to be a way of handing over a part of government revenues to a bunch of deep-pocketed, large investors capable of outlaying funds upfront. Interestingly, this scheme of handing over resources that should legitimately accrue to the government would yield a small fraction of what is needed to finance the government's ambitious infrastructure plan. The `6 lakh crore to be realised from asset monetisation amounts to just about 5% of the `111 lakh crore to be invested five years in projects included in the NIP. The extensive listing of assets that are considered suitable for modernisation suggests that, if the plan is successful, a substantial chunk of assets currently with the government would, for a long period of time, be in the hands of the private sector, which would absorb much of the returns they can yield. In return, the government expects to receive 5% of its planned

investment in infrastructure over the coming five years. That does not make this case to use monetisation of existing assets as a means to create new infrastructural assets all that convincing. More so because it can lead to higher prices/user charges for consumers and less employment of poorer quality for workers. Not surprisingly, their representatives have not been consulted with when drawing up the plan.

Note

1 "Privatise for Efficiency, or Not At All," media release from Australian Competition and Consumer Commission, https://www.accc.gov.au/media-release/privatise-for-efficiency-or-not-at-all

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