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## Revitalizing India's Infrastructure Case for tax-free bonds in the upcoming Budget



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### Article Content:

#### Synopsis

**India faces a significant challenge in balancing infrastructure development and fiscal responsibility. To meet the massive infrastructure needs without straining public finances, reintroducing tax-free bonds is suggested. These bonds can channel private savings into infrastructure projects, offering investors tax-exempt returns and helping the government mobilize long-term funds cost-effectively, leveraging past experiences of success.**

India stands at a pivotal juncture where the dual imperatives of accelerating infrastructure development and maintaining fiscal prudence are clearly converging. The nation's infrastructure needs are monumental, with the World Bank estimating a requirement of US\$ one trillion over the next 15 years, in the urban sector alone. Simultaneously, the RBI has estimated government's debt reaching approximately Rs 181.68 lakh crore by the end of 2024-2025. This scenario underscores the urgency of mobilizing private financing to bridge the infrastructure investment gap without exacerbating the fiscal deficit.

Infrastructure development is the backbone of economic growth, enhancing productivity, creating jobs, and improving the quality of life. The National Infrastructure Pipeline (NIP) had outlined an ambitious investment of Rs 102 lakh crore during FY 2020-2025, encompassing sectors like energy, roads, railways, and urban development. However, achieving these targets necessitates substantial financial resources. Given the government's commitment to fiscal consolidation, there is limited scope for increased public spending. Therefore, attracting private investment becomes imperative to fulfill infrastructure goals without straining public finances.

#### **Tax-Free Bonds: A Strategic Financial Instrument**

Reintroducing tax-free bonds emerges as a strategic instrument to channel private savings into infrastructure projects. These bonds offer investors a fixed interest income exempt from taxation, making them an attractive investment, especially for risk-averse individuals seeking steady returns. For the government, tax-free bonds represent a cost-effective financing mechanism, as the tax exemption allows for lower interest rates compared to taxable bonds. This dual advantage facilitates the

mobilization of long-term funds essential for infrastructure projects with extended gestation periods.

This policy option is also a quasi-tax relief which the government can offer without actually lowering the rates of income tax and will find favor with citizens with an investible surplus. The bond subscriptions could be parked in a special financing window with NABFID, to be suitably leveraged, and backed by an investment guarantee structure to be carved out of the same subscription.

### **Recent Precedent and Success**

India has previously leveraged tax-free bonds with notable success. A few years ago, government-backed entities like the National Highways Authority of India (NHAI), Indian Railways Finance Corporation (IRFC), and **Housing and Urban Development Corporation (HUDCO)** issued tax-free bonds to finance infrastructure projects.

Between the fiscal years 2012 and 2016, government authorized the issuance of tax-free bonds to mobilize resources for infrastructure development. In FY 2011-12, An allocation of Rs 30,000 crore was made for tax-free bonds. This was followed up in FY 2012-13 when the allocation was increased to Rs 60,000 crore. In FY 2013-14, Rs 49,200 crore was successfully raised, and in FY 2015-16, tax-free bonds were reintroduced with an allocation of Rs 40,000 crore. These issuances were thus met with robust investor response, raising Rs 1.8 lakh crores in four years, reflecting the efficacy of tax-free bonds in attracting private capital. These bonds, issued with maturity at 10,15, and 20 years, are currently quite active in the secondary market, indicating a continuing appetite for these instruments for medium- and long-term investment. The reintroduction of such bonds can replicate past successes, providing a reliable funding stream for contemporary infrastructure needs.

Critics may argue that tax-free bonds result in foregone tax revenue. However, this perspective overlooks the multiplier effect of infrastructure investment on economic growth. Enhanced infrastructure leads to increased economic activity, broadening the tax base and potentially offsetting initial revenue losses. Moreover, the alternative - relying solely on public expenditure - could exacerbate fiscal deficits, posing greater economic risks.

As the government prepares the forthcoming budget, it faces the formidable task of balancing infrastructure development with fiscal responsibility. Reintroducing tax-free bonds offers a pragmatic solution to this challenge, enabling the mobilization of private capital for infrastructure projects without further straining public finances, or lowering the rates of income tax for citizens in higher tax brackets and HNIs. By providing a tax-efficient investment vehicle, the government can tap into the substantial pool of domestic savings, fostering a collaborative approach to nation-building. It is an opportune moment to leverage this financial instrument, aligning investor interests with national development goals and fiscal prudence.