Quickonomics

December 2, 2021

Capex towards apex

Public spending is ticking well, multiplier effect can't be far behind

India's public capital expenditure, or capex (of Centre + states), is progressing at a rapid clip, an analysis of official statistics shows.

Two trends stand out. One, both central and state capex have crossed their pre-pandemic levels faster than the gross domestic product (GDP). And two, while the Centre's capex has already crossed the pre-pandemic trendline, state capex, too, should achieve this feat if the budgetary targets are met.

This implies the pandemic did not cause a major permanent loss in government capex in terms of trend.

In the line of sight

While Covid-19 necessitated huge spends by governments around the world, there was a simultaneous decline in their revenues, which led to higher fiscal deficit and debt. India's fiscal deficit widened to 9.4% of GDP in fiscal 2021 from 4.6% in fiscal 2020.

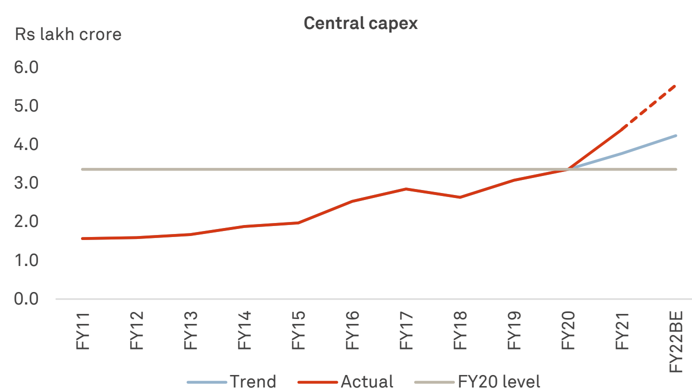
Even so, central capex was 31% higher on-year in fiscal 2021. State capex, too, posted a modest rise over the low base of fiscal 2020. Note that state capex is typically 1.4 times higher than central capex, thereby playing the predominant role in infrastructure building.

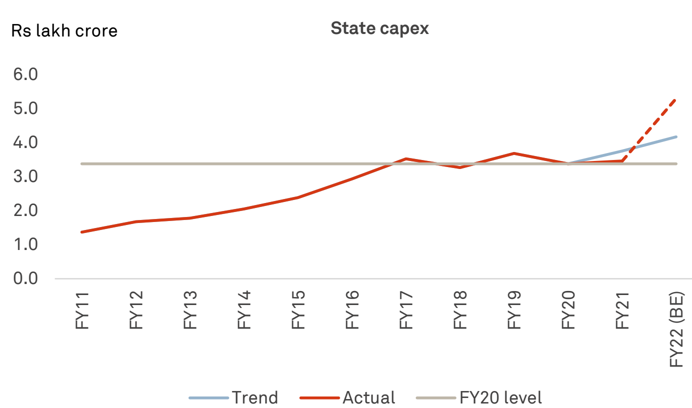
This fiscal, the Centre has begun pruning certain spends, mainly revenue expenditure, as pandemic-related relief measures[1] are rolled back, even as revenue collections have improved.

But it continues to press hard on the capex pedal, which is salutary.

In the first half of this fiscal (April-September), the Centre had spent 41% of its budgeted target for the entire year. On the other hand, state governments have managed to spend 29% of their targets (based on data available for 16 major states[2] that account for ~80% of cumulative state capex).

Central and state capex back on trend





Note: State capex data for 16 major states
Source: Budget documents, Comptroller & Auditor General of India (CAG), Controller General of Accounts (CGA), CEIC, CRISIL

[1] *For instance, budgeted expenditure MGNREGS for this fiscal 2022 is lower than the previous year. Further, central government ministries (with some exceptions) were required to restrict expenditure to 20% of budget estimates in the second quarter of this fiscal. However, relaxations were provided in case of an increase in capex. Source: Financial express, June 30 https://www.financialexpress.com/economy/govt-asks-various-ministries-to-restrict-expenses-at-20-of-budget-allocation-in-september-quarter/2281540/*
[2] *These are: Andhra Pradesh, Bihar, Chhattisgarh, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Odisha, Punjab, Rajasthan, Tamil Nadu, Telangana, and Uttar Pradesh*

So what is the first-half data telling us?

Centre

- Capex for April-October 2021 was ~ Rs 2.5 lakh crore. This is 28% higher on-year (on a low base) and represents 46% of the budgeted spend for the fiscal. Notably it is 26% higher than the pre-pandemic, or fiscal 2020, level for the same period
- Sector wise, capex was higher versus the first halves of fiscals 2020 and 2021, in road transport and highways, railways, housing, telecommunication, and health. Separately, rural development spending (though included under revenue expenditure, ~80% of this is allocated towards creation of capital assets) on rural roads, housing, and other infrastructure showed a 14% increase over pre-pandemic levels

States

- In the first half (April-September), capex rose 78% on-year in the 16 major states analysed. It was 17% higher than in the corresponding period pre-pandemic. These states had spent ~29% of their budget estimates in the first half. While this might seem low, states typically tend to spend most of their capex budgets towards the end of the year. For instance, between fiscals 2012 and 2020, states had, on average, spent only ~31% of budgeted amounts in the first half
- Of the 16 states, six (Chhattisgarh, Kerala, Madhya Pradesh, Punjab, Rajasthan and Telangana) achieved the target set by the Ministry of Finance of spending 45% of budget estimates by the first half[3]. This makes them eligible for availing of additional borrowing of 0.5% of gross state domestic product for incremental capex in this fiscal. On the other hand, Maharashtra, Odisha, and Jharkhand lagged, having spent less than 20% of budgeted capex in the first half

Will capex catch-up to the trend?

If the budgetary targets for capex are met by both the Centre and the states this fiscal, the pre-pandemic decadal trend for the overall Centre + state capex will be revisited.

Despite a tight fiscal position, Centre's capex grew 31% on-year last fiscal. The latest Union Budget targets a 26% increase over the revised estimates of last fiscal. If this is met, the capex by Centre could outpace the pre-pandemic decadal trend by ~12%. Put another way, capex by Centre will have to grow 19% in the second half of this fiscal, on-year, to achieve that.

On the other hand, if states spend as per targets this year, their total capex will cross the decadal trend by the end of this fiscal. That will require a 45%[4] on-year growth in state capex in the second half (compared with 78% in the first half). This could be a tall order. CRISIL Research expects states to meet 80-85% of their capex target this year[5].

What does all this mean for economic recovery?

Public capex can ignite recovery in an environment where weak demand has kept private sector investments tepid.

Studies have shown government capex has a higher multiplier effect on economic output compared with revenue expenditure.

For instance, a 2019 Reserve Bank of India report finds that central government capex has a multiplier of 3.25, i.e., a Re 1 increase in capex pushes output up by Rs 3.25. Similarly, a Re 1 increase in state capex expands output by Rs 2. The multiplier works to 'crowd in' private investment, inducing a disproportionate increase in investments in the economy.

While conducive government support through policy measures such as the production-linked incentive scheme will act as further enablers for such crowding-in, an initial push by way of government spending to lead the investment drive is critical to creating multipliers.

To boot, balance sheets of larger corporates have also improved and capacity utilisation in select sectors is rising, which augur well for investments.

[3]PIB press release, November 12, 2021
[4]Required second half growth (45%) to reach budget estimates for full fiscal appears slower than for the first half (78%) because of low base of first half of last fiscal. Additionally, bulk of the state capex spending typically happens towards the end of the year
[5]For details, refer to CRISIL Research report: "SectorVector: The big undershoot" (September 2021)

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