Budget 2022: In Search Of An Investment Cycle

Last Updated on 01:11 PM IST, 03 Jan 2022

An economy hit by a once-in-a-generation crisis. A k-shaped recovery. Widening inequalities. Not enough jobs.

As the Indian economy tries to lighten the scars of the Covid-19 pandemic, an investment cycle, which can help kick-start a virtuous pattern of jobs, income and consumption, is critical. But amid still tepid demand conditions, the onus to kick-start that cycle is on the government.

In the union budget of 2021, the government stepped up capital expenditure and put building blocks in place to support infrastructure development. Capital expenditure as a share of total budget spending rose to 15.9%, the highest since fiscal year 2008. The peak for capex as a share of total expenditure was in fiscal 2005 at 22.8%.

Will the union budget of 2022, push up the share of capex further, amid competing demands for revenue expenditure?

"Because of the shock to the economy, a lot of economic activity declined. As such, the only way to revive the economy has been stable investments from the government," said NR Bhanumurthy, vice chancellor at the Dr. B.R. Ambedkar School of Economics University. "The government must be proactive to ensure that recovery is strong and entrenched and is not an outlier."

Capital expenditure, according to a study by Bhanumurthy and Sukanya Bose, has a multiplier of 2.45 compared to 0.99 for revenue expenditure, suggesting the economy benefits far more from the former.

Budgeting Vs. Execution

While the central government may step up capital expenditure, other factors play a role in determining the eventual success of that spending in improving economic conditions.

Actual spending, its quality and implementation of projects are among them.

For instance, data available for the first eight months of the current fiscal year suggests that the government had spent just 49.4% of the budgeted capex, though spending has picked up towards later months.

Also project delays are rife, particularly in the government sector.

"The budget outlay on capex is of little consequence because of incompetency and project delays," said Rathin Roy, managing director at Overseas Development Institute. "A higher capital outlay may not necessarily result in increased gross capital formation."

Roy's skepticism is borne out in data.

According to a report by the Ministry of Statistics And Programme Implementation, of 1,873 central infrastructure projects monitored, 598 projects reported a delay in implementation compared to the original deadline. Cost overruns for these delayed projects was at 30.39% of the original cost.

M Govinda Rao, chief economic advisor at Brickworks Ratings shared that view.

"There is a tendency to take in too many projects without resourcefulness causing huge time and cost overruns. There is need for sequencing and allocation of money to complete existing projects," Rao said.

The projects chosen for execution and hence the quality of funding are also important factors.In a recent speech, RBI governor called for quality parameters to monitor fiscal spending.

No one will deny the need for building in quality parameters in public investment, said R Nagaraj, visiting professor at the Centre For Development Studies. "How well is it done, I do not know." Introducing quality parameters may be of little help, added Roy.

The Rising Role Of States

The rising share of states in capital expenditure is another reason why central government capex spends alone cannot ensure economic dividends.

The amount of capital spending with the central government is very little, said Rao." Much of it comes from states."

According to data from the Reserve Bank of India's State Finances Report for 2021-22, states are estimated to spend Rs 7.23 lakh crore on capital expenditure in the current year, compared to the central government's planned spend of Rs 5.54 lakh crore.

States, however, often cut back on capital spending during the course of the year to meet fiscal targets. In 2020-21, according to the RBI, states cut capex in key social and economic services like water supply and sanitation, medical and public health, irrigation and flood control, transport and rural development. "This experience underscores the importance of raising additional resources at the sub-national levels," the RBI report said.

A BloombergQuint analysis of capital expenditure of ten major states in the April-September period, showed that they had used only 33.7% of the budgeted capital spending over this period, while the central government spent 41.4% of its budget.

"States capex constitutes over 60% of overall government capex spending. Many infrastructure spends, such as on health, education, irrigation, and rural development, energy are largely from state capex," said Devendra Pant, chief economist at India Ratings & Research. Take mobility for instance, feeder roads built by states enable connectivity and commute and form an important aspect of the regions development, Pant explained.

The Big Picture

Budget 2022 comes against the backdrop a recovering economy but growth remains fragile. The country's GDP is expected to grow 9.5% this year, with the RBI warning that momentum may peter-out in the second half of the year.

As such, the role of government spending in the economy remains significant. Whether this public spending crowds in or crowds out private investments depends on sector to sector, said Pant.

"In case of the manufacturing sector, public spending can crowd-out private spending but in case of infrastructure it crowds-in investments. For instance, public capex on irrigation in the form of construction of canals or dams helps facilitate private investments in mechanisation," Pant explained by way of an example.

"While one can expect elevated capex spending in this forthcoming budget, it must be kept in mind that the proportion of union and state capex is still at just about 12% of overall investment and would have to go up substantially to have a bigger impact," Pant said.