Quickonomics

February 9, 2022

The curious case of capex

This budget was huge on capital expenditure (capex). Or, was it? Our post-budget week, beyond-the-headline-numbers analysis shows, there is more to it than meets the eye.

Three takeaways

- The 24.5% step-up in central government capex for the next fiscal as presented on February 1, is not as large as it seems, if one considers the 'offset' through a reduction in internal and extra budgetary resources (IEBR), which fund capex of central public sector enterprises (CPSEs)
- That said, capex support for the states has increased and employment generating sectors such as roads and highways, and railways, have gained more attention
- Implementation and frontloading of capex can make or break actual outcomes

First, a few caveats

The union budget impacts public investment in three ways, through:

1. Direct capex, i.e., budgetary allocations to ministries
2. Grants for creation of capital assets[1]
3. IEBR, which is a below-the-line expenditure that does not impact the central government's fiscal deficit

Table 1: The capex layout

Sr no	Capex (Rs lakh crore)	FY18	FY19	FY20	FY21	FY22BE	FY22RE	FY23BE
1	Budgetary capex	2.63	3.08	3.36	4.26	5.54	6.03	7.50
2	Grants for creation of capital assets	1.91	1.92	1.86	2.31	2.19	2.38	3.18
3	Capex by CPSE (IEBR)	6.11	6.08	6.42	4.78	5.83	5.02	4.69
4	Effective Capex (1+2)	4.54	4.99	5.21	6.57	7.73	8.40	10.68
5	Capex by budget and CPSE (1+3)	8.74	9.16	9.77	9.04	11.37	11.05	12.20
6	Grand total capex (1+2+3)	10.65	11.07	11.63	11.35	13.56	13.43	15.37
	% of GDP							
1	Budgetary capex	1.54	1.63	1.67	2.15	2.39	2.60	2.91
2	Grants for creation of capital assets	1.12	1.01	0.92	1.17	0.94	1.02	1.23
3	Capex by CPSE (IEBR)	3.57	3.22	3.20	2.41	2.51	2.16	1.82
4	Effective Capex (1+2)	2.66	2.64	2.60	3.32	3.33	3.62	4.14
5	Capex by budget and CPSE (1+3)	5.11	4.84	4.87	4.57	4.90	4.76	4.73
6	Grand total capex (1+2+3)	6.23	5.86	5.79	5.73	5.84	5.78	5.96
	Growth (%)							
1	Budgetary capex	-7.5	16.9	9.1	27.0	30.0	8.7	24.5
2	Grants for creation of capital assets	15.3	0.4	-3.2	24.4	-5.1	8.5	33.6
3	Capex by CPSE (IEBR)	80.6	-0.4	5.5	-25.5	22.0	-13.8	-6.6
4	Effective Capex (1+2)	0.9	10.0	4.4	26.0	17.7	8.7	27.1
5	Capex by budget and CPSE (1+3)	40.3	4.8	6.7	-7.5	25.8	-2.8	10.4
6	Grand total capex (1+2+3)	35.1	4.0	5.0	-2.4	19.5	-1.0	14.5

Note: BE- budget estimate, RE – revised estimate
Source: Budget documents, NSO, CRISIL

[1]The FRBM Act defines grants for creation of capital assets as grants-in-aid given by the Central Government to state governments, autonomous bodies, local bodies and other scheme implementing agencies for creation of capital assets which are owned by these entities.

Not as high as it sounds

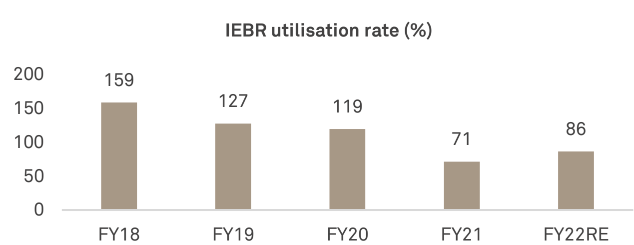
To be fair, governments generally cut capex to make way for higher revenue spending during a crisis. This is exactly what happened during the global financial crisis in fiscal 2009. However, amid the current pandemic, the government has maintained its focus on capex.

The headline figure, or the starting point we pin down, is the budgetary capex outlay of Rs 7.50 lakh crore for fiscal 2023, which is 2.91% of gross domestic product (GDP). Note that this includes a substantially higher 'loans for capex' to states (Rs 1 lakh crore in fiscal 2023BE vs Rs 15,000 crore fiscal 2022RE). Had this been in line with the previous years, budgetary capex for the next fiscal would have been lower at 2.58% of GDP, barely making it to this fiscal's RE.

Two, the increase in 'effective' budgetary capex (which includes grants for creation of capital assets) has been offset by lower IEBR of CPSEs. IEBR has been budgeted at 1.82% of GDP for the next fiscal, much lower than the pre-pandemic average (fiscals 2018-20) of 3.33%.

This shift away from IEBR to budgetary capex is likely the result of poor capex execution by CPSEs of late. Utilisation rates i.e., ratio of actual to budgeted expenditure came down significantly during the pandemic years (see chart 1).

Chart 1: CPSEs are spending less on capex



Source: Budget documents, CRISIL

Three, the budgetary capex in terms of percentage of GDP has been revised up to 2.60% for this fiscal from 2.39% in the budget estimates (see table 1). But this reflects an inclusion of a one-time "capital infusion/loans to AI Assets Holding Ltd/Air India for settlement of past guaranteed and sundry liabilities, not backed by assets," worth Rs 51,971 crore. Deduct this, and the fiscal 2022RE for budgetary capex would actually be lower than the BE, at 2.37% of GDP.

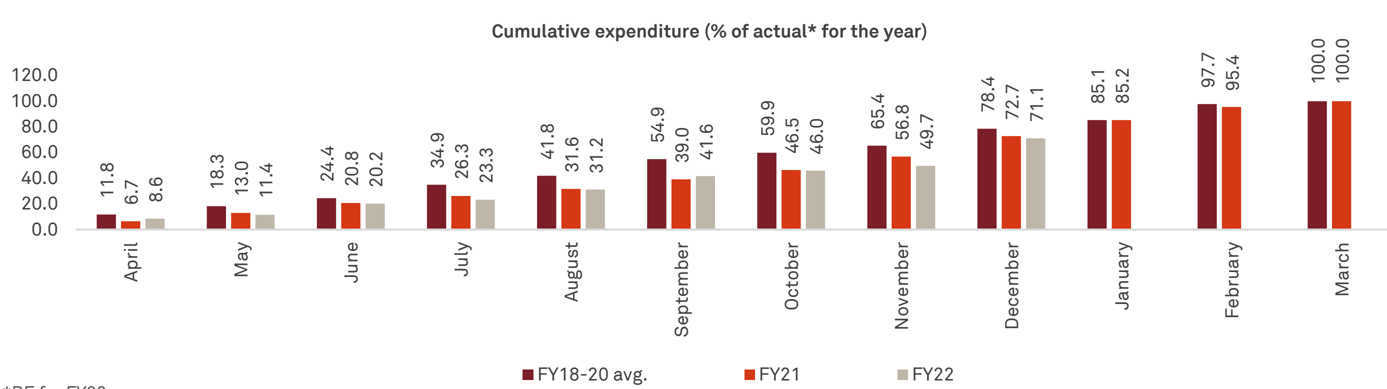
On balance, the overall central capex, i.e., the sum of effective budgetary capex and IEBR, would remain intact at 5.96% of GDP for next fiscal (same as fiscals 2018-20, or the pre-pandemic average).

Frontloading would lift demand faster

To be sure, in the past few years, the central government has been fully able to spend its capex budget — unlike states, which have had a poor utilisation record. The pandemic, however, impacted implementation speeds and ended up back-loading the central capex. For instance, pre-pandemic (fiscals 2018-20, average), ~54.9% of the budgeted capex was spent during the first half of the fiscal. On the contrary, during fiscals 2021 and 2022, a major portion of the spend got pushed towards the last quarter (see chart 2).

Thus, as we argued in our budget impact note[2], frontloading of capex would be crucial to support the economic recovery and provide a bridge from the short to the medium term, especially as the budget has steered clear of a strong consumption push.

Chart 2: Pandemic years slowed capex implementation



**RE for FY22*
Source: CEIC, Budget documents, CRISIL

[2] *'The capex gambit', released on February 2, 2022*

The mix favours employment

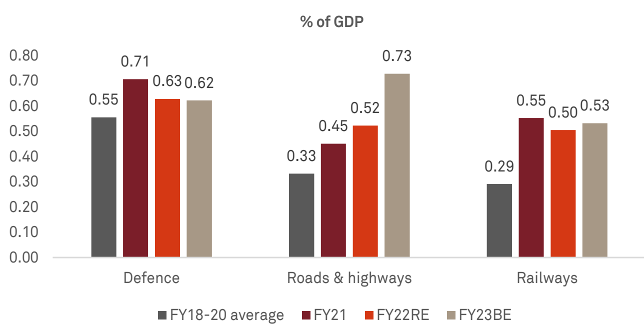
Defence, roads and highways, and railways are the big three line ministries that guzzle central capex (typically, over 70%[3]). Interestingly, both roads and highways and railways capex — that was given a push during the pandemic years — are slated to go up further next fiscal, even as defence capex marginally softens (see chart 3). To be sure, the sharp rise in roads and highways capex to 0.73% of GDP next fiscal from 0.52% in fiscal 2022RE, reflects greater contribution from budgetary resources, in the absence of corresponding IEBR support due to the National Highways Authority of India's large debt build-up in the past. But overall, this expenditure mix trend augurs well for employment generation and achieving higher growth multipliers in the economy.

States must make haste

Finally, the largesse to states,[4] it is hoped, will nudge them to frontload their capex, especially in view of their reduced ability to borrow from the market — as the central government has substantially increased its borrowing programme and yields are on the rise. But states have consistently missed their budgeted capex targets (see chart 4). While there was some improvement in fiscal 2021, they seem to have lost the plot again this fiscal. In the first three quarters, states could incur only ~43% of the budgeted capex[5].

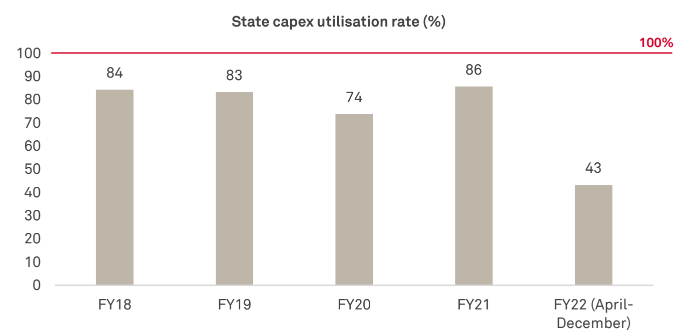
So states must double down on their commitment and make full use of the increased capex loans.

Chart 3: Changing mix



Source: Budget documents, NSO, CRISIL

Chart 4: States on a slow lane



Source: CEIC, RBI state finances studies, CRISIL

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[3]The share was lower in FY22RE and FY23BE as part of the capex has been diverted towards Air India debt and state capital loans, respectively
[4]For perspective, Rs 1 lakh crore of capex loans provision for states represents a reasonable proportion (~14%) of the budgeted state capex (Rs 7.22 lakh crore) for this fiscal
[5]To be fair, some of the lag in capex could be due to the second and third Covid waves during this fiscal, which could have led to some implementation challenges

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