Time To Switch to a More Diversified Capex Strategy
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Time to switch to a more diversified capex strategy

Given the tepid private investments, the govt again has to push capex. Spending on skilling and health has to rise

Sakshi Gupta

The upcoming Union Budget is expected to align India's fiscal strategy towards achieving the Viksit Bharat goal by 2047. For this, sustaining growth above 7 per cent over the next two decades would be essential.

While India's growth averaged at 8.2 per cent over the last three fiscals, more recently growth has begun to slow down and is estimated to be around 6.4 per cent in 2024-25. Even for the next fiscal, growth is at best expected to average between 6.5-7 per cent, especially as rising global headwinds cloud near-term prospects.

Given this backdrop, the Budget has a tall ask of devising a fiscal strategy that balances fiscal consolidation with both near-term counter-cyclical stimulus measures and raising India's long-term growth potential.

In recent years, the government has rightly focussed on capital expenditure (capex) as a growth driver. Government capex went up from ₹3 lakh crore in FY19 to ₹11 lakh crore budgeted for 2024-25 — a more than three fold hike. Higher spending on roads, highways, railways, and interest free loans capex loans to States accounted for majority of this capex increase.

This strategy led to GDP growing at an average of over 8 per cent between fiscal years 2022 and 2024, with the push coming primarily from the above 10 per cent investment growth. Excluding investments, GDP growth averaged at just about 5 per cent during this period. The breakup of investments, available till 2022-23, shows that public capex growth rose between 2021 and 2023, while that of the private sector and households slowed down.

The government capex push has also increased capital productivity with ICOR (the incremental capital output ratio) reducing from 5.4 in 2016-19 to 4.4 in 2022-24.

NO CROWDING IN

Yet, the multiplier effects of government capex in terms of "crowding-in" private investments have been rather weak. Domestic demand constraints, geo-political shocks, and global overcapacities in core sectors like steel have limited a broad-based recovery in the private investment cycle.

As global trade and growth uncertainties, the government might have to continue doing the heavy lifting in driving infrastructure investments in 2025-26.

CAPEX. Building human capital/ISTOCKPHOTO

The Budget could peg capex spending close to ₹11-12 lakh crore in 2025-26 after a likely undershoot from the budgeted capex plan this year. To recall, general and State elections led to a slow start in governments' capex spending in H1 2024-25. Given the current spending run-rates, the Centre's capex could undershoot the initial budgeted target of ₹11 lakh crore and is estimated between ₹9-10 lakh crore.

However, infrastructure investment alone won't sustain medium-term growth. Overtime, this has to be supplemented with a parallel focus on building "human capital". Productivity growth – a critical driver of economic output – requires improvement in labour quality alongside capital efficiency.

The RBI's KLEMS database shows that the quality of labour (as measured by education attainment, earnings etc.) has not improved significantly over the last two decades.

The governments' fiscal strategy must expand beyond traditional infrastructure like roads, highways, and railways. Increased expenditure on health, education, and skilling — conventionally categorised as revenue expenditures — can yield significant multiplier effects on economic output.

According to the RBI, a 1 per cent rise in development expenditure can raise real GDP by almost 5 per cent cumulatively over a period of four years.

Therefore, to move to a higher medium-term growth path, the Budget must emphasise this "true capex" — a combination of spending on building both physical and human capital. While commendable progress has been made in building infrastructure over the last decade, the latter needs to be prioritised now to achieve India's long-term growth aspirations.

The writer is Principal Economist, HDFC Bank