The Budget Bets on Capital Expenditure to Revive Growth

How Will This Strategy Play Out?

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The budget has bet on a hard strategy of government capital expenditure-led growth. This article looks at how the massive increase in capex is planned along with continuing fiscal consolidation in the context of the budget strategy. It also discusses the receipts and expenditure budgets. Finally, it concludes after discussing the likely macroeconomic impact of the budget.

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Like the previous budget, the budget for 2022–23 was also prepared under very difficult conditions. The economy is yet to recover from the unprecedented two-year long pandemic shock. There is a consensus that the economy will register robust growth in 2021–22. Approximately, 8.9% is the number in the *Second Advance Estimates of National Income* just released by the government. However, much of this will be due to the strong base effect of a sharp (-)6.6% gross domestic product (GDP) contraction in 2020–21. This tailwind will be missing in 2022–23.

Further, underlying the high overall growth in 2021–22, there is strong evidence of heightened distress at the base of the wealth-income pyramid among workers, the self-employed and micro, small and medium enterprises (MSMEs) in the informal sector. Distress has risen at the bottom even as net worth has grown enormously for large corporates in the organised sector and leading business families at the top, thanks to a booming stock market, the so-called K-shaped recovery.

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According to a recent Small Industries Development Bank of India (SIDBI) survey submitted to Parliament, 67% of MSMEs shut down for three months or more while half of the surveyed enterprises saw their revenues contract by over 25% (*ENS Economic Bureau* 2022).

Data released by the Centre for Monitoring Indian Economy (CMIE) indicates that unemployment had spiked sharply during the first quarter of 2021–22 and remains high at over 7%, while the labour participation rate has declined precipitously, especially for women. Also, in a recent article, Kaiker and Gaiha (2022) use CMIE survey data to show that during the peaks of both the first and second waves of the pandemic, the Engel curve for food shifted up in both rural and urban areas. It implies that consumers were cutting back on other consumption items to preserve their most basic consumption, food. They also note the shift in consumption within food from superior to inferior food items.

These symptoms of heightened distress are most visible among the poorest three deciles of consumers. This micro-level evidence matches macroeconomic data on the declining share of private consumption in aggregate final demand and some industry-specific data such as the slow-down in offtake of many fast-moving consumer goods and the contraction in demand for consumer durables like two-wheelers.

The need for sustaining rapid economic recovery and the evidence of distress among MSMEs and poor consumers called for an expansionary fiscal policy with enhanced social protection. On the other hand, price movements appeared to suggest that the markets were supply-constrained and pointed to the need for fiscal restraint. The consumer price index (CPI) inflation rate was close to the upper end of the Reserve Bank of India (RBI) target inflation band at 5.7% (it has now hit the limit at 6%), while core inflation (non-food, non-fuel) was above the limit and the wholesale price index (WPI) inflation remained high at 13%.

Another factor calling for fiscal restraint was the yield on dated government securities, which remained elevated despite the best efforts of the RBI. Yield on the 10-year government security (G-sec) continued to hover over 6%, reflecting the large pre-emptive market borrowing by the government. There were additional pressures prevailing on the external front. Though export growth was robust and higher than import growth during the last couple of months, the current account deficit remained large. More importantly, the capital account saw a net outflow of foreign portfolio funds. This was mainly because markets were factoring in the impending rise in the United States (US) interest rates and higher oil prices.[1]

Against this challenging background, the finance minister Nirmala Sitharaman has bet on a hard strategy of government capital expenditure (capex) led growth to ease all the other prevailing pressures (Mundle 2022). However, the massive increase in capex is planned along with the continuing fiscal consolidation, a further reduction in the fiscal deficit in 2022–23. So how is the increase in capex to be accommodated within this fiscal deficit cap? The budget strategy is to pay for it partly through higher revenues, especially tax revenues, and partly by reallocating expenditure from revenue expenditure to capex. How will this strategy actually play out? We return to this question further below.

The rest of the article is organised as follows. First, is a more granular discussion of the budget strategy outlined above. Then the article discusses tax revenue and other aspects of the receipts budget. Then it discusses the expenditure budget, in particular the reallocation of shares from revenue to capex. Later, the article discusses the likely macroeconomic impact of the budget and and finally concludes.

Budget Strategy

The 2022–23 budget has a very clear strategy—its important feature is the massive emphasis on capex. The budget estimate (BE) provides for a total capex of ₹7.5 trillion as compared to a capex of ₹5.5 trillion in 2021–22 (Table 1).[2] This amounts to a 36.2% year-on-year (y-o-y) capex increase in 2022–23 on top of the 27% and 29.2% increases in 2020–21 and 2021–22, respectively. Thus, the 2022–23 (BE) raises to a whole new level the thrust on capex which has been a characteristic feature of fiscal policy under the present government. Note that the increase is substantial not only in relation to 2021–22 but also relative to the pre-pandemic year 2019–20 (Table 1, column 10).

It is also important to identify the reasons for the huge increase in the union government capex.

Table 1: Receipts, Expenditure and Deficits

		₹ Crore				Percentage Change				
		2019–20 (Actuals)	2020–21 (Actuals)	2021–22 (RE)	2022–23 (BE)	2020–21 (Actuals) over 2019–20 (Actuals)	2021–22 (RE) over 2020–21 (Actuals)	2022–23 (BE) over 2021–22 (RE)	2021–22 (RE) over 2019–20 (Actuals)	2022–23 (BE) over 2019–20 (Actuals)
0	1	2	3	4	5	6	7	8	9	10
1	Gross tax revenue (union + states)	20,10,059 (9.9)	20,27,104 (10.3)	25,16,059 (10.8)	27,57,820 (10.7)	0.8	24.1	9.6	25.2	37.2
2	Tax revenue (union)	13,56,902 (6.7)	14,26,287 (7.2)	17,65,145 (7.6)	19,34,771 (7.5)	5.1	23.8	9.6	30.1	42.6
3	Non-tax revenue	3,27,157 (1.6)	2,07,633 (1.1)	3,13,791 (1.4)	2,69,651 (1.0)	(-)36.5	51.1	(-)14.1	(-)4.1	(-)17.6
4	Total revenue receipts	16,84,059 (8.3)	16,33,920 (8.3)	20,78,936 (9.0)	22,04,422 (8.5)	(-)3.0	27.2	6.0	23.4	30.9
5	Non-debt capital receipts	68,620 (0.3)	57,626 (0.3)	99,975 (0.4)	79,291 (0.3)	(-)16.0	73.5	(-)20.7	45.7	15.6
6	Total non-debt receipts (4 + 5)	17,52,679 (8.6)	16,91,546 (8.6)	21,78,911 (9.4)	22,83,713 (8.9)	(-)3.5	28.8	4.8	24.3	30.3
7	Total expenditure, of which	26,86,330 (13.2)	35,09,836 (17.8)	37,70,000 (16.2)	39,44,909 (15.3)	30.7	7.4	4.6	40.3	46.9
	7.1 Revenue expenditure	23,50,604 (11.6)	30,83,519 (15.6)	31,67,289 (13.6)	31,94,663 (12.4)	31.2	2.7	0.9	34.7	35.9
	7.2 Capital expenditure	3,35,726 (1.6)	4,26,317 (2.2)	6,02,711 (2.6)@	7,50,246 (2.9)	27.0	41.4@	24.5@	79.5	93.5
8	Revenue deficit (7.1–4)	6,66,545 (3.3)	14,49,599 (7.3)	10,88,352 (4.7)	9,90,241 (3.8)	117.5	(-)24.9	(-)9.0	63.3	48.6
9	Fiscal deficit (7–6)	9,33,651 (4.6)	18,18,291 (9.2)	15,91,089 (6.9)	16,61,196 (6.4)	94.8	(-)12.5	4.4	70.4	77.9
10	Primary deficits*	3,21,581 (1.6)	11,38,422 (5.8)	7,77,298 (3.3)	7,20,545 (2.8)	254.0	(-)31.7	(-)7.3	141.7	124.1

(1) Figures in parenthesis () indicate percentage of GDP; (2) BE: Budget estimates; RE: Revised estimates, AE: Advanced estimates; (3) GDP (₹ crore): 2019–20: 2,00,74,856 (2nd RE), 2020–21: 1,98,00,914 (1st RE), 2021–22: 2,32,14,703 (1st AE), 2022–23: 2,58,00,000 (BE); (4) * Fiscal deficit-interest payment. @ Capital expenditure for 2021-22 (RE) includes capital infusion/loans to AI Assets Holding Limited (AIAHL)/Air India (AI) for settlement of past guarantees and sundry liabilities, not backed by assets amounting to ₹51,971 crore. Excluding this, capital expenditure in RE is estimated as ₹5,50,740 crore. Accordingly, the percentage change between 2020–21 (actuals) and 2021–22 (RE) and between 2021–22 (RE) and 2022–23 (BE) would be 29.2 and 36.2, respectively. Capital expenditure as % of GDP would be 2.4 for 2021–22.

Source: *Budget at a Glance for 2021–22 and 2022–23.*

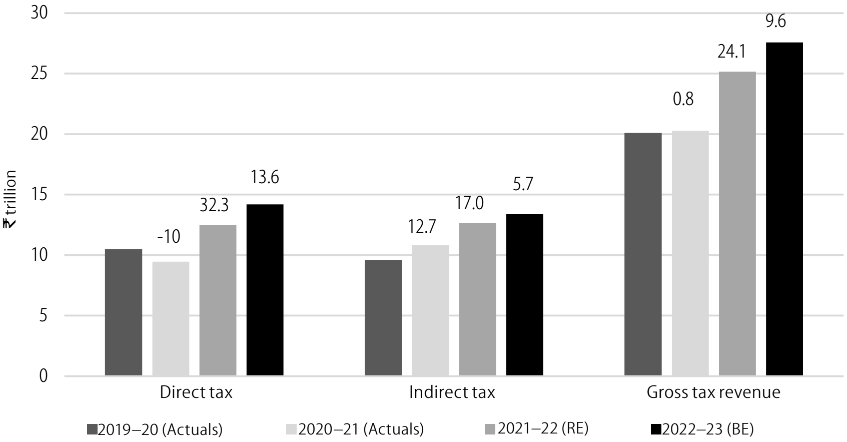
Table 2: Capital Expenditure

		Capital Expenditure (₹ crore)				Share in Total Capital Expenditure (%)				Percentage Change	
		2019–20 (Actuals)	2020–21 (Actuals)	2021–22 (RE)	2022–23 (BE)	2019–20 (Actuals)	2020–21 (Actuals)	2021–22 (RE)	2022–23 (RE) (BE)	2022–23 (BE) over 2021–22 (RE)	2022–23 (BE) over 2019–20 (Actuals)
0	1	2	3	4	5	6	7	8	9	10	11
1	Capital expenditure	3,35,726	4,26,317	6,02,711	7,50,246	100.0	100.0	100.0	100.0	24.5	123.5
2	General services	1,24,807	1,42,746	1,54,060	1,73,419	37.2	33.5	25.6	23.1	12.6	38.9
	2.1 Defence services	1,11,092	1,34,305	1,38,851	1,52,370	33.1	31.5	23.0	20.3	9.7	37.2
3	Social services	9,492	7,110	10,230	11,878	2.8	1.7	1.7	1.6	16.1	25.1
	3.1 Education, sports, art, and culture	2,216	226	73	111	0.7	0.1	0.0	0.0	52.8	(-)95.0
	3.2 Medical and public health	1,640	3,578	3,741	5,537	0.5	0.8	0.6	0.7	48.0	237.6
4	Economic services	1,75,570	1,65,971	3,83,166	4,24,892	52.3	38.9	63.6	56.6	10.9	142.0
	4.1 Agriculture and allied activities	3,294	2,292	8,682	3,954	1.0	0.5	1.4	0.5	(-)54.5	20.0
	4.2 Rural development	0	0	0	0	0.0	0.0	0.0	0.0		
	4.3 Energy	1,374	3,019	3,619	1,963	0.4	0.7	0.6	0.3	(-)45.8	42.8
	4.4 Transport	1,38,895	1,22,449	2,93,649	3,18,047	41.4	28.7	48.7	42.4	8.3	129.0
	4.5 Communications	5,220	4,929	5,525	53,651	1.6	1.2	0.9	7.2	871.0	927.8
	4.6 Industry and minerals	6,266	5,212	6,597	7,676	1.9	1.2	1.1	1.0	16.4	22.5
5	Grants-in-aid and contributions	25,856	1,10,491	55,255	1,40,057	7.7	25.9	9.2	18.7	153.5	441.7

BE: Budget estimates; RE: Revised estimates.

Source: *Expenditure Profile*, Statement 16, Budget 2021–22 and 2022–23.

Figure 1: Tax Receipts, 2019–20 (Actuals) to 2022–23 (BE)



Figures on top of the bars denote percentage change over previous year.
Source: Compiled by the authors.

The largest increase of about ₹85,000 crore is under the head "Grants in aid and contributions" (Table 2, p 41). This is mostly the increase in the interest-free 50-year loan to states in aid of their capital expenditure. The second largest increase of about ₹48,000 crore is for communications. The third largest increase of ₹25,000 crore is for transport, mostly roads and railways. Though transport accounts for the largest share of government capex at 42%, the share is now down from 49% in the 2021–22 revised estimate (RE). The y-o-y increase is fairly modest at 8.3%. The fourth major increase in government capex of about ₹14,000 crore is for defence. Its share of government capex in 2022–23 (BE) is 20.3%, down from 23% in 2021–22 (RE).

Of these four main items, the increased capex allocation for communications and defence would be largely on equipment with relatively low employment intensity. However, the incremental allocation for transport (mostly roads and railways) and capex assistance to states (a lot of it also for roads under the Pradhan Mantri Gram Sadak Yojana [PMGSY]) are likely to have a high employment intensity.

It should be emphasised that the capex on infrastructure has both a supply-side effect and a demand-side effect. Investment in infrastructure increases the productive capacity of the economy, but with a gestation lag. This supply-side impact on growth plays out over the medium-to-long term. But investment also has a short-term demand generating impact, particularly for labour-intensive projects in railways and roads, like the PMGSY. If there is a pipeline of projects ready to launch, these can immediately generate additional employment and put money in the hands of low-income workers with a high consumption propensity. Their short-term multiplier effect on income and employment will be similar to income support programmes like the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) in addition to their medium-to-long term growth effects.

The second major feature of the budget is continuing fiscal consolidation. The fiscal deficit, which was compressed from 9.2% of GDP in 2020–21 to 6.9%[3] in 2021–22 (RE) is to be further compressed to 6.4% in 2022–23 (Table 1). In our article analysing the budget for 2021-22, we had said that the fiscal consolidation was premature given that we were still at the height of the pandemic and the economy had just gone through an unprecedented contraction in 2020–21 (Mundle and Sahu 2021).

However, growth will be high in 2021–22 taking India's GDP above the pre-pandemic level of 2019–20. Meanwhile, inflation is gaining momentum, and the large government borrowing is still putting pressure on the financial market. We feel, therefore, that it is time to take the fiscal consolidation process forward to 6.4% with a 0.5% reduction in the fiscal deficit (Table 1).

This is of course much higher than the deficit reduction target set earlier under the Fiscal Responsibility and Budget Management (FRBM) Act, which fell by the wayside in the wake of the pandemic. It is also higher than the fiscal deficit envisaged by the Fifteenth Finance Commission (2020) in its principal scenario. Instead, it corresponds to the commission's low growth (<7%) scenario. Unfortunately, the Medium-term Fiscal Policy (MTFP) Strategy Statement in the budget documents (Ministry of Finance 2022b) does not spell out the annual fiscal consolidation path as is required under the FRBM Act. However, the MTFP does state that the 6.4% deficit target for 2022–23 is in line with the goal of reducing the fiscal deficit to 4.5% of GDP by 2025–26 announced during the 2021–22 budget presentation.

The 0.5% of GDP reduction in the deficit for 2022–23 is not insignificant. It raises a question about how the massive increase in capex is to be accommodated within the planned fiscal compression. Partly, the increase in capex will be financed through additional revenues, especially tax revenues. Partly, it will be financed by reallocating a portion of the revenue expenditure share to capex. The revenue expenditure is projected to remain more or less flat at ₹3.19 trillion in 2022–23 (BE) as compared to ₹3.17 trillion in 2021–22 (RE), implying a significant reduction in real terms (Table 1).

Buoyant Tax Revenue and Receipts

Five key features characterise the receipts budget for 2022–23: reasonable tax revenue projections, maintenance of stable direct tax rates, a large number of changes in customs duty rates, the stabilisation of goods and services tax (GST) receipts, and modest but realistic estimates of realisation from disinvestment proceeds.

Tax revenues are the main component of net receipts of the union government at 85% (Table 3, p 43). The projected increase in the gross tax revenue as well as tax revenue of the union government, net of transfers to states, has been set at a modest 9.6% (Figure 1). With the nominal GDP projected to grow at 11.1%, this implies an overall tax revenue buoyancy of only 0.96. This is despite a projected direct tax revenue increase of 13.6%, implying a direct tax buoyancy of 1.23. The modest tax revenue projections are mainly on account of the expected low realisation of indirect taxes.

On the direct taxes side, the projection of 13.6% growth is much lower than the huge 32.3% increase in 2021–22. But that was mainly on account of the strong base effect of a decline in direct tax receipts during the economic contraction of 2020–21. The assumed direct tax buoyancy of 1.23 is actually quite optimistic compared to pre-pandemic norms. Corporation tax revenues and income tax revenues are expected to increase by 13% and 14%, respectively.

There is no change in the direct tax rates, exemption limits or deductible allowances. This maintenance of a stable tax rate structure is to be welcomed. Among the few changes in direct tax provisions, the most novel is the introduction of taxation on virtual asset transactions called cryptocurrencies. Other important direct tax provisions include a 15% surcharge on long-term capital gains, the one-year extension of the tax incentive for start-ups and also for the commencement date for concessional taxation of new enterprises. Several administrative simplification measures have also been announced to ease the compliance burden of taxpayers.

Indirect taxes have been projected to grow only by 5.7%, implying a very low buoyancy of 0.51. This is mainly on account of the reduction in union excise duty on petroleum products. An encouraging feature of indirect tax receipts is the estimated y-o-y increase of 15.8% and 14.3%, respectively, in central GST and GST Compensation Cess (Table 3). Coming on top of the large increases registered in 2021–22, it suggests that the teething troubles encountered in the early years following the GST rollout have now been largely ironed out.

A negative feature, on the other hand, is the increasing recourse to cesses and surcharges, which are not shared with the states. Another negative feature is the ad hoc tampering with customs duty rates, distorting relative prices.

A quick scan of the Memorandum Explaining the Provisions in the Finance Bill, 2022 (Ministry of Finance 2022d) indicates that the effective customs duty has been raised for about 137 items either by raising the basic duty or by eliminating concessions and exemptions immediately or in a lagged manner. As against this, duty rates have been reduced or reduced temporarily under the phased manufacturing programme (PMP), for some 119 items. The net impact on the effective average tariff rate cannot be rigorously assessed without a detailed quantitative exercise. However, the impact of such ad hoc tampering in recent years has been an increase in protectionist tariff rates. It has reversed a quarter century of tariff reforms designed to induce domestic cost-efficiency through exposure to import competition.

Non-tax revenues, which account for 12% of the union government's non-debt receipts, are projected to decline by 14% (Table 3). The largest decrease is projected for "dividends and profits" of the union government-owned enterprises, which had increased by a whopping 52% in 2021–22. That increase and decrease in 2022–23 is mainly on account of changes in the transfer of surpluses of the RBI.

The other major component of non-debt receipts is non-debt capital receipts, mainly disinvestment of government equity in public enterprises. As compared to a target of ₹1.75 trillion in 2021–22 (BE), the actual realisation was only ₹78,000 crore. The estimate for 2022–23 has now been set at a modest ₹65,000 crore (Table 3). Instead of unrealistic, overly ambitious targets which are grossly underachieved, it is much better to set realistic targets in the BE, keeping in view market conditions on the ground.

The lower target set for 2022–23 should not be interpreted as a reversal of the government's disinvestment policy. It did effectively sell off Air India, which had bled taxpayers for decades through

Table 3: Tax Revenue, Non-tax Revenue, Non-debt Capital Receipts, and Total Non-debt Receipts

		₹ Crore				Percentage Change				
		2019–20 (Actuals)	2020–21 (Actuals)	2021–22 (RE)	2022–23 (BE)	2020–21 (Actuals) over 2020–21 (Actuals)	2021–22 (RE) over (Actuals)	2022–23 (BE) over 2021–22 (RE)	2021–22 (RE) over 2019–20 (Actuals)	2022–23 (BE) over 2019–20 (Actuals)
0	1	2	3	4	5	6	7	8	9	10
1	Gross tax revenue (union + states)	2,0,10,059	20,27,104	25,16,059	27,57,820	0.8	24.1	9.6	25.2	37.2
	1.1 Direct tax[#]	1,0,49,549	9,44,875	12,50,000	14,20,000	(-)10.0	32.3	13.6	19.1	35.3
	1.2 Indirect tax[@], of which	9,60,510	10,82,229	12,66,059	13,37,820	12.7	17.0	5.7	31.8	39.3
	1.2.1 Customs	1,09,283	1,34,750	1,89,000	2,13,000	23.3	40.3	12.7	72.9	94.9
2	Tax revenue (net to union), of which	13,56,902 (77.4)	14,26,287 (84.3)	17,65,145 (81.0)	19,34,771 (84.7)	5.1	23.8	9.6	30.1	42.6
	2.1 Central GST	4,94,072 (28.2)	4,56,334 (27.0)	5,70,000 (26.2)	6,60,000 (28.9)	(-)7.6	24.9	15.8	15.4	33.6
	2.2 UT GST	3,035 (0.2)	2,764 (0.2)	3,327 (0.2)	3,706 (0.2)	(-)8.9	20.4	11.4	9.6	22.1
	2.3 GST compensation cess	95,553 (5.5)	85,192 (5.0)	1,05,000 (4.8)	1,20,000 (5.3)	(-)10.8	23.3	14.3	9.9	25.6
	2.4 Cess and surcharge (inclusive of GST compensation cess)	2,54,512 (14.5)	2,97,836 (17.6)	5,30,652 (24.4)	5,08,982 (22.3)	17.0	78.2	-4.1	108.5	100.0
3	Non-tax revenue, of which	3,27,157 (18.7)	2,07,633 (12.3)	3,13,791 (14.4)	2,69,651 (11.8)	(-)36.5	51.1	(-)14.1	(-)4.1	(-)17.6
	3.1 Interest receipts	12,349 (0.7)	17,113 (1.0)	20,894 (1.0)	18,000 (0.8)	38.6	22.1	(-)13.9	69.2	45.8
	3.2 Dividends and profits	1,86,133 (10.6)	96,877 (5.7)	1,47,353 (6.8)	1,13,948 (5.0)	(-)48.0	52.1	(-)22.7	(-)20.8	(-)38.8
4	Revenue receipts (2 + 3)	16,84,059 (96.1)	16,33,920 (96.6)	20,78,936 (95.4)	22,04,422 (96.5)	(-)3.0	27.2	6.0	23.4	30.9
5	Non-debt capital receipts	68,620 (3.9)	57,626 (3.4)	99,975 (4.6)	79,291 (3.5)	(-)16.0	73.5	(-)20.7	45.7	15.6
	5.1 Disinvestment of government equity	50,304 (2.9)	37,897 (2.2)	78,000 (3.6)	65,000 (2.8)	(-)24.7	105.8	(-)16.7	55.1	29.2
6	Total non-debt receipts (4 + 5)	17,52,679 (100)	16,91,546 (100)	21,78,911 (100)	22,83,713 (100)	(-)3.5	28.8	4.8	24.3	30.3

(1) Figures in parenthesis () indicate percentage of total non-debt receipts. (2) BE: Budget estimates, RE: Revised estimates.

[#] Direct tax includes income, corporate and other minor direct taxes. These are gross figures inclusive of states' share. [@] Indirect tax includes central GST, UT GST, integrated GST, GST compensation cess, customs, union excise duties, and other minor indirect taxes of the union government.

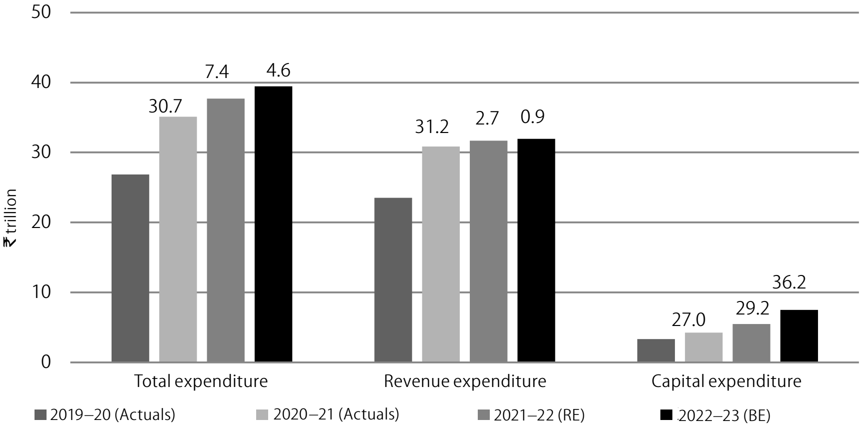
Source: *Receipts Budget for 2021–22 and 2022–23.*

massive capital infusions, and it has now also launched a massive sale of Life Insurance Corporation equity.

Expenditure Reallocations

It was mentioned above that one important means of financing the massive projected increase in capex is the reallocation of expenditure shares from revenue to capital expenditure. Thus, revenue expenditure is projected to remain more or less flat at ₹32 trillion, a significant reduction in real terms, while capital expenditure is projected to increase by over 36% to ₹7.5 trillion (Table 1 and Figure 2). Apart from this revenue to capex reallocation, there are also very significant changes in allocations across different sectors.

Figure 2: Union Government Expenditure—Total, Revenue , and Capital, 2019–20 (Actuals) to 2022–23 (BE)



Figures on top of the bars denote percentage change over previous year.
Source: Compiled by the authors.

Among economic services, we have noted earlier the large allocations for infrastructure sectors like transport, communications and energy, mostly for capex. But this has been done largely at the cost of social protection. The 2022–23 allocation for food subsidy has been reduced to ₹2 trillion and that for the MGNREGA reduced to ₹0.73 trillion (Table 4). Thus, the two main schemes of social protection in India are being cut by about 28% and 26% respectively compared to the 2021–22 (RE). The allocation for the Pradhan Mantri Kisan Samman Nidhi, the income support scheme for farmers, is more or less flat at ₹68,000 crore—a reduction in real terms. The budget appears to assume that the unprecedented two-year pandemic shock is now history and all its adverse effects on jobs and incomes are behind us. This is despite the evidence cited earlier of high levels of unemployment and prevailing distress among the bottom 30% of our population.

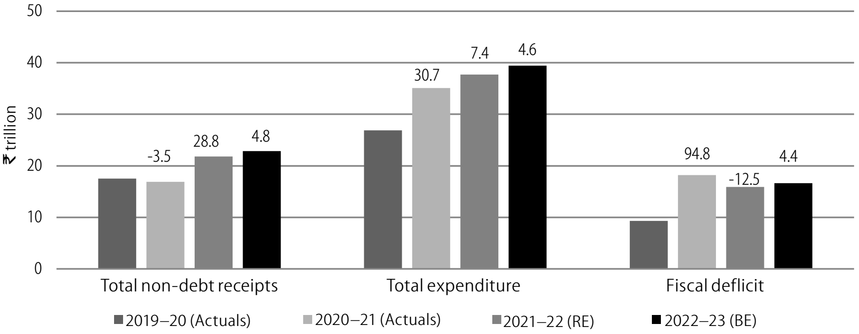
Among social services, the allocation for "medical care and public health" has been slashed by nearly 38%, mainly on account of the reduction in grants-in-aid to states and union territories. Less than

Table 4: Expenditure and Allocations

		Expenditure (Revenue + Capital) ₹ Crore				Share in Total Expenditure (%)				Percentage Change	
		2019–20 (Actuals)	2020–21 (Actuals)	2021–22 (RE)	2022–23 (BE)	2019–20 (Actuals)	2020–21 (Actuals)	2021–22 (RE)	2022–23 (BE)	2022–23 (BE) over 2021–22 (RE)	2022–23 (BE) over 2019–20 (Actuals)
0	1	2	3	4	5	6	7	8	9	10	11
1	Total expenditure	26,86,330 (12.5)	35,09,836 (12.1)	37,70,000 (16.0)	39,44,909 (19.0)	100	100	100	100	4.6	46.9
2	General services	12,66,553 (9.9)	13,70,906 (10.4)	16,14,879 (9.5)	17,44,921 (9.9)	47.1	39.1	42.8	44.2	8.1	37.8
2.1	Interest payment and servicing of debt	6,12,070 (0.0)	6,79,869 (0.0)	8,13,791 (0.0)	9,40,651 (0.0)	22.8	19.4	21.6	23.8	15.6	53.7
2.2	Defence services	3,18,665 (34.9)	3,40,094 (39.5)	3,68,418 (37.7)	3,85,370 (39.5)	11.9	9.7	9.8	9.8	4.6	20.9
3	Social services	1,38,609 (6.8)	1,67,648 (4.2)	2,26,198 (4.5)	2,20,137 (5.4)	5.2	4.8	6.0	5.6	(-)2.7	58.8
3.1	Education, sports, art, and culture	49,841 (4.4)	46,376 (0.5)	52,541 (0.1)	59,005 (0.2)	1.9	1.3	1.4	1.5	12.3	18.4
3.2	Medical care and public health	28,937 (5.7)	35,076 (10.2)	74,820 (5.0)	46,549 (11.9)	1.1	1.0	2.0	1.2	(-)37.8	60.9
4	Economic services	7,13,518 (24.6)	12,64,080 (13.1)	12,64,707 (30.3)	12,00,541 (35.4)	26.6	36.0	33.5	30.4	(-)5.1	68.3
4.1	Agriculture and allied activities, of which	2,38,506 (1.4)	7,02,495 (0.3)	4,83,432 (1.8)	3,74,257 (1.1)	8.9	20.0	12.8	9.5	(-)22.6	56.9
4.1.1	Food subsidy	1,08,688 (0)	5,41,330 (0)	2,86,469 (0)	2,06,831 (0)	4.0	15.4	7.6	5.2	(-)27.8	90.3
4.1.2	PM Kisan	48,714 (0)	60,990 (0)	67,500 (0)	68,000 (0)	1.8	1.7	1.8	1.7	0.7	39.6
4.2	Rural development	74,342 (0.0)	1,13,910 (0.0)	1,00,866 (0.0)	77,023 (0.0)	2.8	3.2	2.7	2.0	(-)23.6	3.6
4.2.1	MGNREGA	71,687 (0)	1,11,170 (0)	98,000 (0)	73,000 (0)	2.7	3.2	2.6	1.9	(-)25.5	1.8
4.3	Energy	61,803 (2.2)	55,500 (5.4)	28,776 (12.6)	30,915 (6.3)	2.3	1.6	0.8	0.8	7.4	(-)50
4.4	Transport	1,48,961 (93.2)	1,34,762 (90.9)	3,07,448 (95.5)	3,36,981 (94.4)	5.5	3.8	8.2	8.5	9.6	126.2
4.5	Communications	29,372 (17.8)	4,49,84 (11.0)	35,503 (15.6)	83,832 (64.0)	1.1	1.3	0.9	2.1	136.1	185.4
4.6	Industry and minerals	85,745 (7.3)	1,19,870 (4.3)	1,23,241 (5.4)	1,25,224 (6.1)	3.2	3.4	3.3	3.2	1.6	46.0
5	Grants-in-aid and contributions	5,55,145 (4.4)	7,07,202 (15.6)	6,64,215 (8.3)	7,79,310 (18.0)	20.7	20.1	17.6	19.8	17.3	40.4
6	Capital expenditure	3,35,726 (12.5)	4,26,317 (12.1)	6,02,711 (16.0)@	7,50,246 (19.0)	12.5	12.1	16.0@	19.0	24.5@	123.5

(1) Figures in parenthesis ( ) indicate capital expenditure as percentage of total expenditure in the sector. (2) BE: Budget estimates, RE: Revised estimates.
@ See notes in Table 1. Capital expenditure as % of total expenditure would be 14.6 in 2021–22 after adjusting for capital infusion in Air India. The corresponding y-o-y increase in 2022–23 would be 36.2%.
Source: *Expenditure Profile*, Statement 16, Budget 2021–22 and 2022–23. For reconciliation with expenditure shown in Demand for Grants and Annual Financial Statement, see Statement 17 of *Expenditure Profile.*

Figure 3: Union Government Non-debt Receipts, Expenditure, and Fiscal Deficit, 2019–20 (Actuals) to 2022–23 (BE)



Figures on top of the bars denote percentage change over previous year.
Source: Compiled by the authors.

a year ago, the second COVID-19 wave laid bare the fragility of our healthcare system, particularly at the grassroots level. It virtually collapsed at the height of the second wave. Medical experts and epidemiologists have also repeatedly emphasised the key role of vaccinations in containing the third wave and the importance of sustaining a robust vaccination programme to prevent another wave of the pandemic. The drastic cut in the allocation for healthcare under these conditions is inexplicable and very unfortunate.

Two points should be noted regarding the expenditure allocation under general services. First, interest payments on government debt goes up by 15.6% in 2022–23 (BE). At 23.8% of the union government expenditure, it is the highest in recent years. A non-discretionary charged item, it now pre-empts nearly a quarter of the total union government expenditure or nearly 43% of revenue receipts, squeezing down other priority expenditure. This is the single most important consideration, among others, for containing the growth of government debt.

Second, among such priority spending, we have not only social and economic services discussed above but also defence. Defence expenditure will be raised by only 4.6% in 2022–23 (BE), which would imply a reduction in real terms at the current rate of inflation. The share of defence in the total spending has been reduced in recent years from 11.9% in 2019–20 to 9.8% in 2022–23 (BE). This amounts to almost a one-fifth reduction in the share of defense expenditure in three years. This is a matter of serious concern in the context of our deteriorating security environment.

The Macroeconomic Impact

The 2022–23 budget strategy is the same as that pursued by this government in earlier years, subject to adjustments necessitated by the pandemic, that is a focus on capex to revive growth combined with fiscal consolidation. The question is, how will this strategy actually play out?

To address that question, it is necessary to take note of the macroeconomic context in which the budget has been prepared. The budget has not made any projection of real growth in 2022–23. It has simply assumed a nominal GDP growth of 11.1%, which can be consistent with many combinations of real growth and inflation. The RBI's real growth forecast of 7.8% would imply an inflation rate of only 3.3%. The *Economic Survey* real growth projection of 8%–8.5% would imply an even lower inflation rate of only 2.6%–3.1%. It has been widely commented that the 11.1% nominal growth assumption is perhaps too low.[4]

However, the most recent high frequency data-based now casting/forecasting model developed by Bhattacharya and Mundle (2021) forecasts a real growth rate of 5.1% in 2022–23. Bhattacharya has also recently forecast an inflation rate of 6.2% for 2022–23 employing the Bhattacharya and Kapoor (2020) inflation forecasting model. Combining the two, the nominal growth forecast works out to 11.3%, quite similar to the 11.1% nominal growth assumed in the budget.

But the Bhattacharya forecast is for the headline CPI inflation rate. The GDP deflator in the *Second Advanced Estimates of National Income* is much higher at 10.5%. Furthermore, it is likely that in the economic disruption caused by the Russo–Ukraine war, real growth would dip lower and inflation would rise even higher. On balance, the nominal growth may turn out to be significantly higher than assumed in the budget. This could reduce the budgeted fiscal deficit of 6.4% in two ways. First, if nominal growth is significantly higher than the projected, then the actual tax revenue would also be higher. Without a corresponding adjustment of expenditure, the absolute level of the deficit would be significantly lower. Second, the denominator of the fiscal deficit ratio, that is the nominal GDP, would be higher.

Thus, fiscal consolidation could be much stronger than planned in the budget estimate. Alternatively, expenditure could be adjusted upwards through supplementary demand for grants while still meeting the fiscal deficit target using the fiscal space generated by higher revenues. This in our view would be the preferred course of action. As mentioned above, the massive increase in capex in the budget, along with the compression of the budgeted deficit, was made possible by cuts in the expenditure on social protection and public health. With citizens still reeling from the impact of COVID-19 and lost livelihoods, especially in the informal sector, reversing the cuts would alleviate distress in the lowest deciles of the wealth-income pyramid.

Such a policy would also make the fiscal stance more expansionary. Reference was made at the outset to the complex macroeconomic situation, which is pulling the required fiscal stance in different directions. High inflationary pressures suggest that the economy is supply constrained, calling for fiscal restraint. On the other hand, prevailing low levels of capacity utilisation in many sectors suggest that there is a positive output gap, calling for an expansionary fiscal stance. The picture is obviously oversimplified when a combination of supply- and demand-constrained sectors are all aggregated into a single sector macroeconomic picture.

On balance, we would argue that the economy is experiencing cost push inflation, mostly imported through rising oil and other commodity prices, along with a positive output gap. In such a situation, fiscal compression to reduce demand may simply lower growth without reducing inflation, a classic stagflation outcome. The high level of public debt, servicing that crowds out necessary social, and economic and defence expenditure may necessitate fiscal consolidation as explained below. But under current conditions it is best to stay with a moderate fiscal correction path, about 0.5% of GDP per annum reduction in the fiscal deficit as budgeted (Table 1 and Figure 3 [p 45]).

Fiscal consolidation is urgent in view of the prevailing high level of public debt, the union government debt in the present context. The total union government debt, as defined under the FRBM Act, is estimated at 60.2% for 2022–23 (BE), up from 59.9% in 2021–22 according to the medium-term strategic framework (MTSF) (Ministry of Finance 2022b). Along with the liabilities of the states, the total government debt is estimated at close to 90% of GDP. Though high, this level of debt is not unsustainable.

As Chinoy and Jain (2021) have demonstrated, at the present level of debt and prevailing structure of interest rates, there is a knife edge around the nominal growth rate of 9%. If the medium-term nominal growth path is above this level, the debt:GDP ratio will gradually come down. If the nominal growth path is below 9%, then the debt:GDP ratio would rise and become unsustainable. Since nominal growth rates are well above this knife edge, India is currently not at the risk of falling into a debt trap.

However, apart from the interest cost of public debt pre-empting a large share of revenue receipts, such high levels of debt also put great pressure on financial markets. Apart from market borrowing, the other sources of financing the fiscal deficit include the National Small Saving Fund investments in special union government securities, public accounts balances, net external borrowing, etc. But market borrowing is by far the largest component in financing the fiscal deficit. The MTSF indicates that market borrowing in 2022–23 is set at a massive ₹14.95 trillion, the highest ever, except in 2020–21. As a consequence, the yield on the benchmark 10-year G-sec has remained elevated at over 6% despite the RBI's best efforts and it even touched 7% after the budget was presented. This high cost of money, exacerbated by the recent outflow of foreign portfolio investments, is an impediment for private investment.

On the external front, the impact of tariff increases in the budget on external trade also raises serious concerns. Several successive budgets have been raising effective duty rates in many tariff lines under the mistaken notion that raising protective tariffs is a necessary concomitant of self-reliance. The fact is that the same expenditure switching from imports to exports can be achieved more effectively, without distorting relative prices, by allowing the rupee to depreciate. Furthermore, exposing Indian producers to external competition would induce them to raise productivity and lower costs.

Two schemes of relevance here are the Production-linked Incentive Scheme and the Emergency Credit Line Guarantee Scheme for reviving MSMEs that struggled during the pandemic. Though not exclusively linked to exports, these schemes have had considerable traction among large and MSME producers respectively, and will help to strengthen their competitiveness. Such strengthening of competitiveness, combined with reviving our engagement with the Regional Comprehensive Economic Partnership (RCEP) to enable embedding of Indian products in global supply chains, is the most robust and durable path to Atmanirbhar.

Conclusions

The budget has been prepared under difficult conditions. The budget strategy for reviving growth in this context is the same that has been pursued for several years by the present government, namely, a strong emphasis on high capex combined with fiscal consolidation.

This has come at the cost of reducing the share of expenditure on social protection as well as medical care and public health. It is unfortunate, given the prevailing high levels of unemployment and distress among the lowest deciles of the wealth-income pyramid and the revealed fragility of our healthcare system. It is not clear whether the budget will give a strong push to aggregate demand since the impact of high public capex will be blunted by the compression of expenditure on social protection and healthcare.

Though compressed, the deficit will still entail very large market borrowing and this will continue to put pressure on financial markets. Raising protectionist tariff barriers to protect domestic produces is also ill advised. Finally, the provisions of the budget discussed above have been overtaken by events, the impact of the war in Ukraine. This is now the greatest threat confronting the recovery of the economy.

NOTES

[1] These external pressures will be exacerbated by the Russo–Ukraine war which broke out within a few weeks after the presentation of the budget.

[2] This is the adjusted figure after correcting for the capital infusion in Air India to settle past guarantees and sundry liabilities prior to privatisation. See footnote to Table 1.

[3] The budget assumed a nominal GDP of ₹2,32,14,703 crore for 2021–22. The *Second Advance Estimates of National Income* has now revised this figure to ₹2,36,43,875 crore. Adjusting this figure would accordingly change the GDP projection for 2022–23 and fiscal deficit numbers.

[4] See, among others, Ahluwaiia (2022) and Rangarajan and D K Srivastava (2022).

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