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Quickonomics

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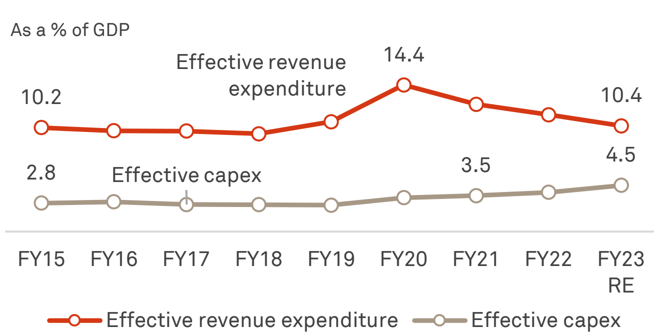
Budgetary capex at the cost of welfare spend? Not quite

Union Budget 2023-2024 has brought a renewed capex thrust by the government – the largest in 15 years at that — to a record 4.5% of GDP, with sectors such as railways, highways and petroleum benefiting the most.

The capex support to growth gives reason to cheer as growth is expected to slow next fiscal, with slowing global growth hurting exports, the one-time demand effect seen in contact-based services domestically expected to slow, and rising interest rates likely to pinch demand in certain segments.

In pursuit of higher capex



Source: Budget documents, CSO, CEIC, CRISIL

To be sure, with fiscal consolidation also an imperative amid slowing revenue growth, it was far from easy to create room for capex.

The budget did so by axing revenue spends. To wit, effective revenue expenditure (revenue expenditure excluding revenue grants given for capex) drops from a peak of 14.4% of GDP in fiscal 2021 to 10.4% in fiscal 2024, which is nearly on a par with the pre-Covid ratio.

There are undisputed cuts in allocation for food and fertilizer subsidy, where lower prices and modifications in the free food scheme are reducing the government's expenses. But there are also some perceived trade-offs to rural welfare support spends.

During the pandemic, despite the agriculture sector being exempt from stringent lockdown-related restrictions, the spread of the virus and fear amid supply chain and demand shocks impacted employment in the sector. Many workers left cities and returned to their villages, increasing demand for rural jobs.

Added to that, the intense heatwave in April-May 2022, patchy rainfall during the southwest monsoon season, and high agriculture input costs resulting from the geopolitical crisis also hurt agriculture incomes.

As all this put pressure on the rural job market, the government stepped in by increasing allocation under its three key rural focussed schemes that have been known to yield both infrastructure creation and employment generation – Mahatma Gandhi Rural Employment Guarantee Scheme (MGNREGA), Pradhan Mantri Awas Yojana (PMAY) for affordable housing, and Pradhan Mantri Gram Sadak Yojana (PMGSY) for rural road construction.

In the years of the pandemic, the budget made way for higher spending on these rural-focussed schemes to support livelihoods of the most vulnerable sections of the economy.

Over time, however, rural livelihoods have improved, led by a broad-based recovery (rural wage growth improved to 6% on-year average in October-November 2022 from 4.4% in April-June 2022, and from a trough of 2.2-3% during the pandemic months), with some support from higher agriculture export incomes due to rising global prices and movement of people back to urban areas. In recent months, softening rural inflation is supporting the improvement in purchasing power.

Thus, the need for large rural welfare schemes has been diminishing, leading to normalisation of these spends.

The latest budget has continued to pave the way for such normalisation.

- For MGNREGA, the allocation is reduced to Rs 60,000 crore for fiscal 2024, compared with Rs 89,400 crore in fiscal 2023. But this should not be alarming as MGNREGA is a social safety net scheme and is driven by demand. So, periods of rural stress or shocks result in higher-than-budgeted spending under this scheme. Even for fiscal 2023, the budgeted MGNREGA allocation was Rs 73,000 crore. In fact, even in the past, MGNREGA actual spends have on average been higher than budgeted (chart).

- Similarly, PMAY sees only a 3.2% increase in allocation on-year, though the rural component sees a higher increase of 12.5% on-year. The revised estimate for the overall scheme for fiscal 2023 was a 60.7% higher-than-budgeted. Allocations under this scheme had nearly quadrupled during fiscals 2021 and 2022
- For PMGSY, the allocation is unchanged next fiscal, after spending increased by 36% in fiscal 2023.

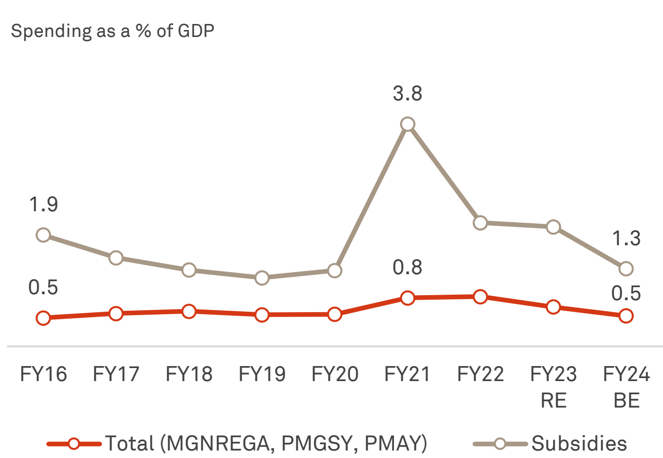
These are the three main employment-generating and asset-creating schemes of the central government and make up a large portion of the expenditure budget of the Department of Rural Development.

Therefore, a fair way to assess budget 2023 allocation on the rural employment-generating welfare schemes would be to add up the allocation for these three schemes.

The total allocation to the three saw a 14.5% drop in fiscal 2024 after 8.4% haircut in fiscal 2023. What is important to note, though, is that spending during the pandemic had surged ~50% in fiscal 2021 and a further 22.6% in fiscal 2022. So, the recent reduction is only an attempt to pare it down from those levels.

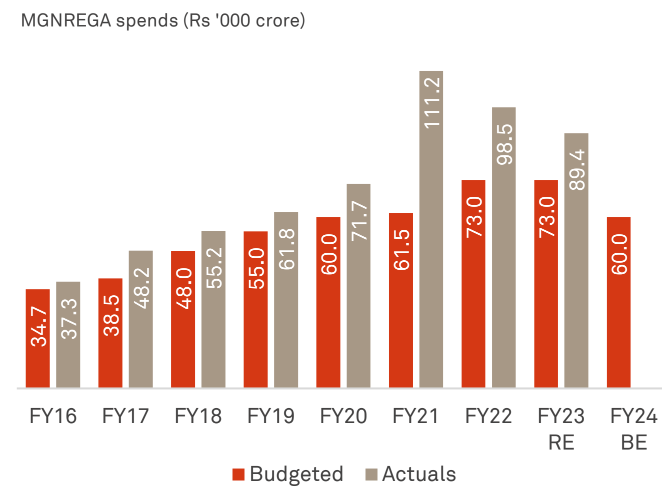
Indeed, as a percentage of GDP, the allocation is down from a peak of 0.8% in fiscal 2021, to 0.5% in fiscal 2024, which again is comparable to the pre-pandemic ratio.

A haircut for revenue spends



Source: Budget documents, CEIC, CRISIL

Schemes such as MGNREGA stretched in the past to accommodate higher demand



Source: Budget documents, CEIC, CRISIL

For the record, two other schemes with major allocations are Indira Gandhi National Old Age Pension Scheme (IGNOAPS) and National Livelihood Mission. Together, the allocation to these two schemes is a much smaller part of the Ministry of Rural Development (13% compared with 85% for PMGSY, MGNREGA and PMAY-Rural put together).

To reiterate, therefore, the pandemic led to an increase in revenue expenditure, led by a bloated subsidy bill and higher welfare spends (especially on employment-generating, asset-creating schemes) as the government provided support to citizens to alleviate the impact of income loss and unemployment caused by the lockdown. As the domestic economy recovers, the government has reduced revenue expenditure in some of these areas in favour of increasing capex to support growth amid expectations of a global slowdown.

The government is hoping demand for rural support schemes will be lower in future as growth broad-bases and picks up quicker in urban areas compared with rural areas. As migrant workers move back to cities and towns, the demand for MGNREGA is likely to be lower than the previous few years.

To that extent, the lower allocation to key rural welfare spends are an effort by the government to channel funds away from areas that have gained some strength, towards those that need support.

The push for capex for major infrastructure projects in the country should also have a multiplier effect on jobs and economic growth over the next few years.

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