CAPITAL EXPENDITURES - GS III MAINS

Q. The increasing capital expenditure is significant against the backdrop of the economic slowdown caused due to the Covid-19 pandemic, coupled with a decline in employment ratio. Discuss the measures taken by India to increase its capital expenditure. (15 marks, 250 words)

News: *Budget 2024: Govt likely to increase capex to propel economic growth*

What's in the news?

- To propel the economic growth, the government is likely to maintain its momentum on increasing capital expenditure, especially for the infrastructure sector in the upcoming Budget.

Key takeaways:

- “We estimate Government of India to budget for a capex of ₹10.2 lakh crore in FY25, implying a relatively sedate YoY expansion of about 10 per cent, compared to over 20 per cent expansion seen in each of post-COVID years. The slowdown in capex growth is likely to have some bearing on economic activity and GDP growth," said ICRA in its pre-Budget expectations.

Capital Expenditure:

- Capex (Capital Expenditure) refers to the money spent by the government that leads to **creation of assets that are long-term in nature and yield benefits for years in the future.**
- Expenditure on acquiring land, development of machinery, building, health facilities, schools etc. are examples of Capex. Capital Expenditure includes
    - Acquiring fixed and intangible assets.
    - Upgrading and repairing an existing asset.
    - Repayment of loans.

Significance of Capital Expenditure:

1. Multiplier effect:

- Capex has the maximum multiplier effect (change in rupee value of output with respect to a change in rupee value of expenditure).
- This multiplier effect works through the **expansion of ancillary industries and services and job creation.**
- According to the National Institute of Public Finance and Policy, every rupee spent as a revenue expenditure has a multiplier effect of Rs 0.98 while Capex delivers a **multiplier effect of Rs 2.25 in the year** it is incurred and Rs 4.80 during the course of the entire expenditure.

2. Labour productivity:

- It also increases labour participation, takes stock of the economy and raises its capacity to produce more in future.

3. Macroeconomic stabilizer:

- Capital expenditure is an effective tool for countercyclical fiscal policy and acts as a macroeconomic stabilizer.

4. Revenue generation:

- Capital expenditure leads to the creation of assets that are long-term in nature and allow the economy to generate revenue for many years and **boosts operational efficiency.**

5. Liability reduction:

- Along with the creation of assets, repayment of loans is also capital expenditure as it reduces liability.

6. Economic growth:

- Capex by the government creates a **conducive environment** which leads to crowding in of private investment.
- Capex by the government can put money in the hands of people which leads to demand creation and starts a virtuous cycle of growth in the economy.

7. Crowding-in of investment:

- It is a phenomenon that occurs when higher government spending leads to an increase in economic growth and therefore encourages firms to **invest due to the presence of more profitable investment opportunities.**
- The crowding-in effect is observed when there is an increase in private investment due to increased public investment, for example, through the construction or improvement of physical infrastructures such as roads, highways, water and sanitation, ports, airports, railways, etc.

8. Recover from Slowdown:

- The increasing capital expenditure is significant against the backdrop of the economic slowdown caused due to the **Covid-19 pandemic,** coupled with a decline in employment ratio.

Distinction between Capital and Revenue Expenditure

Capital Expenditure	Revenue Expenditure
Incurred in **acquiring or improving permanent assets** not meant for resale. May add to value of an existing asset	Is a **routine expenditure** incurred in the normal course of business and includes cost of sales and maintenance of fixed assets.
Increases earning capacity	**Maintains** the earning capacity
It is normally a **non-recurring** outlay.	It is usually a **recurring** item
It produces **benefit over several years.** **Thus a small part is charged** to income statement as depreciation and the rest **appears in the balance sheet**	It is **consumed within an accounting year i.e. benefits only one year.** **Thus** entire amount is **charged to income** statement.**Does not appear** in the balance sheet.
Is an item of balance sheet	Shown in Trading and profit & loss A/c

Concerns of Capital Expenditure:

- Capex for covering the **losses incurred by public enterprises** does not result in benefits for the economy.
- Capex that **ignores critical areas like health, education** etc. has limited positive effects.
- Spending money in capex while sustaining a **high fiscal deficit has risks increasing inflation, current account deficit and risks of financial stability** which could negatively affect investor confidence.
- For Capex to be effective, it has to be supplemented with a **conducive regulatory regime.** Capex has to be **implemented effectively at all levels** (central, state and local) to ensure a positive outcome.
- **Project implementation costs and time taken is higher in India**, which further impacts the multiplier effect of increased capital expenditure.

WAY FORWARD:

1. Timely Implementation:

- Emphasis on timely implementation of projects within the earmarked outlay by **strengthening monitoring, redressal mechanisms and processes for controlling project delays.**

2. Easing Process:

- **Optimising project management** processes of all the key stakeholders, including implementation agencies, state governments, vendors and others will ensure efficiency during project implementation.

3. Ensuring quality control:

- The quality control in turn, will result in capital assets providing benefits over a longer term following the multiplier effect.

4. Managing Revenue Expenditure:

- The **maintenance, repair and operation (MRO) expenditure**, which is part of revenue expenditure, will have to be monitored during project implementation.
- It also needs to **cut down on inefficient revenue expenditure** and focus on creating a balanced and stable virtuous cycle, which can have positive knock-on effects over the long term.

Capex is an important tool used by the government to **stimulate growth and attract investment.** However, money spent on Capex must be well distributed and supported by other policy measures to achieve the desired results.