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THE NEW PUBLIC INVESTORS

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The missing piece in India's GDP growth story — investments — has made a slow but firm comeback. What's more, our analysis shows it is the states and extra budgetary resources of the public sector units (PSUs), and not the Centre's budgeted outlay, that are driving this comeback.

First, the overall figures. Fixed investments grew 12.3 per cent on average in real terms in the past three quarters, compared with 5.3 per cent in the previous three. Overall investment ratio (share of gross fixed capital formation in GDP) rose to 31.4 per cent in fiscal 2018 from 31.1 per cent in fiscal 2017 and 30.3 per cent in fiscal 2016. That remains below the 34 per cent plus achieved in fiscals 2012 and 2013.

A standard policy response in times of slowing investments — as India and other emerging countries have shown in recent years — is to boost public investments. When these are geared towards infrastructure creation, such policies are also expected to incentivise or "crowd in" private monies. Second, it is important to note that the government's contribution to total investments is small but rising. The share of the government's investment in GDP rose from 3.5 per cent in fiscal 2012 to 4.2 per cent in 2017. But is the Centre's budgetary outlay the main source of public investment spending? The answer is, surprisingly, no.

That brings us to our third and important observation.

We find that the Centre's role in capital spending is low and declining, suggestive of the restricted fiscal space. In contrast, it is the states and internal and extra budgetary resources (IEBR) of PSUs that are largely funding public investments.

Public investments are of three types: One, central government expenditure (we consider only non-defence capital expenditure, as defence expenditure generally does not lead to productive asset creation); two, IEBR of the PSUs; and three, state government expenditure.

The first two find mention in the central government's budget. However, IEBR is funded by PSU resources (profits, loans, and equity and does not get counted as government expenditure, so they do not feature in the fiscal deficit math).

The breakdown of government capital expenditure in the economy into central (budgetary support plus IEBR) and state expenditure shows that the share of states has risen from 32.6 per cent in fiscal 2010 to 43.4 per cent in fiscal 2018. Share of the states' capital expenditure (capex) has got a major upward push since fiscal 2015 when the 14th Finance Commission recommendations were implemented, and states not only started getting a bigger share of the divisible pool of taxes, but also more untied funds.

States also resort to off-budget accounting to check their fiscal deficits, and since these do not get captured in the state budget documents, they are difficult to analyse.

For sure, the aggregate off-budget expenditures of all states would be sizeable. For instance, large infrastructure expenditure by Maharashtra for its metro rail and Mumbai trans-harbour link projects, or by Telangana for implementing Mission Bhagiratha, involves big monies. Clearly, states are spending more than what their budgets indicate.

On the other hand, a break-up of the central expenditure — in the budget and IEBR — shows capex through the former is quite low and declining — from 45.5 per cent in fiscal 2010, it came down to 28.2 per cent in fiscal 2018.

Central non-defence capex in fiscal 2018 was Rs 6.64 lakh crore, the central outlay or the central government expenditure from its own pocket was mere Rs 1.87 lakh crore, while the balance Rs 4.77 lakh crore was IEBR spending.

In contrast, states spent Rs 5.10 lakh crore that fiscal. Clearly, the Centre's budget outlay is restricted and public investments in the economy are being primed more by state governments and IEBR.

Which states are at the forefront of capex? We consider here the capex of 18 non-special category states (the 11 special category, or hilly, states are omitted as they get differential treatment, especially grants from the Centre), which together make up for ~90 per cent capex of all states.

Capex at the state level is defined as the sum of capital outlay, and loans and advances. Since 75 per cent of discom debt was taken up by the state governments in fiscals 2016 and 2017 under the Ujwal Discom Assurance Yojana, it is prudent to remove this part from the state capex to get a more meaningful comparison.

Five states — Uttar Pradesh, Bihar, Karnataka, Telangana, and Maharashtra — accounted for about half the capex of the states considered in the past two years. Of these, Telangana, Bihar, and Uttar Pradesh had the highest proportion of capex relative to their total spending.

With the central government's continued focus on fiscal consolidation, the reliance on state governments and IEBR to undertake public investments may continue to be the way forward.

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