Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

News: The last remaining engine of India’s capital expenditure cycle, state government capex, is losing steam and could slow down further as state finances come under increasing strain, posing a risk to a capex revival in the country.

Prelims and Mains focus: about capital expenditure; the recent economic slowdown and its impact on various sectors of Indian economy

Background:

Over the past two decades, state governments have led public investments in India. As private investments dried up in the past few years, the role of state governments became even more central to sustain investments in the country.

However, with state finances under stress, state capex plans have been trimmed, further dampening a subdued capex cycle in the country. Rising expenditure on the revenue account, including populist spending on farm loan waivers, has crimped the ability of state governments to drive the capex cycle. The past couple of quarters saw a sharp drop in new project announcements, data from the project tracking database of the Centre for Monitoring Indian Economy (CMIE) shows.

The value of new state government projects saw a 75% decline from the year-ago period in the June-ended quarter of 2019, settling at the lowest in 15 years.

If the 15th Finance Commission decides to give in to the exorbitant demands of the central government, state finances would be hit badly and their capex plans will likely be trimmed further.

Why is state govt led capex expenditure crucial?

- How important state government-funded capex has become in the past few years can be understood by comparing the shares of government-funded capex and privately-funded capex over the years.
- Five years ago, private investments accounted for the bulk of investment projects. Now, the shares have reversed, with government-funded projects dominating investments across states.

Reasons for downfall in investments:

- One big reason for the decline in private investments relates to the rise in stalled...
projects. If projects were getting stalled largely because of lack of clearances earlier, now they are stalled because of lack of finances. Investments have declined the most in states such as Jharkhand, Chhattisgarh, West Bengal, Punjab, and Kerala and in all of these states stalling rates, expressed as a share of projects under implementation, have shot up considerably.

- So far, government-funded projects kept the capex cycle going, even if at a tepid pace. Now with state finances facing rising strain, this channel of investment finance has also been jeopardized.
- Policy failures have contributed to the investment squeeze. The prime example of this is the Ujwal DISCOM Assurance Yojana (UDAY) under which states were allowed to breach their fiscaldeficit targets to facilitate a one-time bailout of debt-laden power distribution companies (discoms).
- States were also supposed to enact power sector reforms to bring down losses and to revise power tariffs so that power companies turned viable and did not need life support in future. This was supposed to have led to a revival in the power sector and thus paved the way for new investments in the sector. The reality has been pretty disappointing.
- Power sector investments, have dried up across states that implemented the scheme, CMIE data shows.

**Conclusion:**

With state finances being hit because of UDAY-related as well as other commitments, room for capex funding is likely to remain low. With the last remaining capex driver in the country being hit, a sustained revival in India’s investment cycle is likely to be further delayed.