CAPITAL EXPENDITURE - GS III MAINS

Q. Addressing violence against women requires a multifaceted approach across all life stages. Discuss (15 marks, 250 words)

News: *Share of Capital Expenditure shrinks, but guarantees not the only reason*

What's in the news?

- The share of capital expenditure to the total outlay of the Budget Chief Minister Siddaramaiah presented has come down to 15% from 16.5% in the Budget he presented in July 2023.

Key takeaways:

- But, contrary to popular perception, it is not the guarantee schemes alone, but salaries, pensions, and interest payment on loans that have ballooned significantly reducing funds for capital expenditure.

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.

Difference between Capital Expenditure and Revenue Expenditure:

Capital Expenditure	Revenue Expenditure
Capital expenditure is the expenditure by the government for the development of fixed assets.	Revenue Expenditure is the expenditure by the government which does not impact its assets or liabilities.
Along with the creation of assets, it also includes repayment of loan.	It includes salaries, interest payments, pension, and administrative expenses.
If an item has a useful life of more than one year, it is be capitalized (i.e., can be considered CapEx).	If an item has a useful life of less than one year, it shouldn't be capitalized (i.e., cannot be considered CapEx).
Capital expenditure is a payment for goods or services recorded - or capitalized - on the balance sheet.	Revenue Expenditure must be expensed on the income statement instead on the balance sheet.

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.

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.