# Where is the government spending?

**March 23, 2021 I Economics**

Government spending tends to have a significant bearing on the economic fortunes of a region, more so in the current scenario which has witnessed a dramatic fall in economic activity and thereby limited spending by the population and businesses at large.

The expenditure that a government intends to undertake is detailed in its budget which is linked with flows of revenue from various sources, which is in turn tied to a certain baseline projection of economic growth. The pandemic and resultant restrictions of the last one year led to a dramatic drop in economic growth in the country and has upset the finances of the government at the centre as well as the states. Their budget calculations for FY21, which was generally made before the lockdown has been greatly distorted (a few states presented their Budgets in June and September 2020).

Faced with a sharp drop in revenues in FY21, the government had a challenge in managing its expenditure, a large portion of which is committed and must be honoured. Add to this, there has been the additional expenditure towards welfare programmes and measures for mitigating the impact of the pandemic. Further, tasked with ensuring future economic growth and employment opportunities for its population, the expenditure towards capital asset building was also required. All this made it imperative for the central and state governments to strike a fine balance in their allocation towards the various heads of expenditure.

To get insights into the spending of the government we have analysed the FY22 Budget of the central government and that of nineteen states[1] (including the NCT of Delhi) that have announced their budgets. These nineteen states accounted for 82% of the total expenditure of all states and UTs of the country as per the budget estimates for FY21. The FY22 budgets along with providing the estimates of expenditure allocation and income from various sources for FY22 also provide the revised estimates of the expenditure and revenues for FY21. This helps identify the deviations between the budget and revised estimates for FY21.

We have separately examined here the revenue expenditure and capital expenditure of the centre and states for FY21 and FY22 to understand the spending dynamics at both the levels of government and identify similarities and differences.

## Revenue Expenditure

**Government has incurred higher revenue expenditure in FY21(RE) over FY20**

In FY21, both Central government and 19 state governments have registered notable growth in revenue expenditure compared with FY20. The revenue expenditure for the Central government has grown by 28% in FY21, outpacing the growth for the 19 states at 12.3%. All 19 states have registered a positive growth and 11 states, accounting for 53% of total revenue expenditure of the states, have registered double digit growth in FY21 (Y-o-Y). All three key heads (social, economic and interest) have grown by double digits in FY21 for both Central and 19 state governments.

In case of health and family welfare, 13 states accounting for 70% of the total spending on health, have registered double-digit growth in FY21. Uttar Pradesh is the only state in case where health care spending in FY21 has remained at the same level as in FY20.

- 19 states have increased their spending on education, sports and arts by 6.8% in FY21. However, the spending by Central government in FY21 has remained at the same level as last year.
- Spending on agriculture has been more in FY21 than FY20 for both states (aggregate level) and Central government. However, some states like Karnataka (-25.2%), Madhya Pradesh (21.8%) and West Bengal (-6.5%) have witnessed notable decline in expenditure.
- All 19 states have spent more on rural development in FY21 compared with the previous year.

**FY21 revised v/s budget estimates: Negative deviation for states, positive deviation for Centre**

States' revenue expenditure, which accounts for around 85% of the total budget size, witnessed a fall in revised estimates of FY21 by 4.5% compared with the budget estimates of FY21. 10 states registered a contraction which is sharper than the overall de-growth of the 19 states (4.5%). On the other hand, the revenue expenditure of the Central government grew by 14% in FY21 compared with the budgeted numbers chiefly on account of higher food subsidies and increased spending towards rural development (under the head of MGNREGA). It can be observed from the Chart 1 below that the spending for key heads (economic, social and interest expenses) of the governments was lower than budgeted for the states but higher for the centre. These three heads account for almost 3/4th of the revenue expenditure for the state governments and 70% for the Central Government.

**Chart 1: Deviation in budget and revised estimated : FY21**

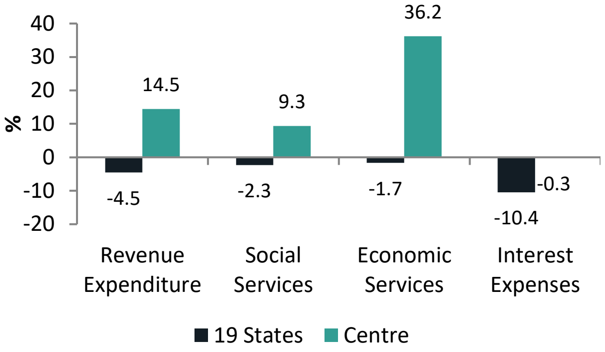



**Table 1: Key sub-heads of revenues expenditure - % change in FY21 RE vs BE numbers**

| FY21(RE) vs FY21(BE) | 19 States | Centre |
|---|---|---|
| **Social services** | | |
| Health and family welfare | 1.8 | 13.0 |
| Education, Sports, Arts | -7.5 | -11.0 |
| Social security | 6.3 | 380.4 |
| **Economic services** | | |
| Agriculture | -2.8 | 119.9 |
| Rural Development | -0.5 | 78.3 |
| Energy | 7.4 | -11.2 |

Source: CMIE, CARE Ratings calculation

- Under social services, 3 key heads (Health and family welfare; education, sports, arts and social security) account for almost 75% of the spending on social spending for all 19 states.
  - There is a clear pattern in case of spending under these 3 sub-heads with negative deviation seen in case of education, sports and art and positive deviation in case of Health and family welfare and social security for both state governments and Central government.
  - The higher spending by Central government on health and family welfare by 13% is more than the state governments (1.8%). For Central government, the higher estimate is on account of the implementation of the "Emergency Response and Health Systems Response Preparedness package" for the COVID-19 pandemic. On the other hand, states like Maharashtra (15% deviation), Tamil Nadu (14.3%), West Bengal (20.2%) have spent more on health following the outbreak of the pandemic while states like Uttar Pradesh (-22%), Rajasthan (-5%) have registered a decline in spending in FY21(RE) over FY21 (BE)
  - The spending under social security rose sharply and is estimated to be higher by almost 4 times for the Central government as the Central Government announced direct benefit transfer under the Pradhan Mantri Jan Dhan Yojana for women account holders and Indira Gandhi National Old Age Pension (total aggregating to Rs 33,771 crs). In case of state governments, the revised spending is more by 6.3% with 6 states (Bihar, Maharashtra, Gujarat, Kerala, Rajasthan, West Bengal) spending more than the average for 19 states in FY21.
- Agriculture and Rural Development, which together account for 54% of the total spending under economic services for the 19 states, recorded a contraction of 2.8% and 0.5% in FY21 compared with the budget estimates (but was higher relative to FY20). However, the Central Government registered robust growth on account of higher food subsidies (under food storage and warehousing) and increased spending under Mahatma Gandhi National Rural Employment Generation Scheme (MGNREGA) (under rural development).
- In case of energy, which accounts for 20% of total spending under economic services, spending by state governments was higher by 7.4% as against lower spending by the Central government. 7 states (38% share) had more spending in FY21 compared with the budget estimates.
- Interest expenses accounts for 12% of total revenue expenditure for state governments and 26% for the Central government. For the 19 state governments, the outlay fell by little more than 10% as against unchanged value of interest expenses for Central government in FY21(BE) and FY21(RE).

[1] Bihar, Chhattisgarh, Gujarat, Haryana, Himachal Pradesh, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Manipur, NCT of Delhi, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh, Uttarakhand, West Bengal and Nagaland

**FY22 – Higher spending by states, lower by Centre**

Revenue expenditure is budgeted to grow by 11% in FY22 for the 19 states as against contraction of 2.7% for the Central government. 9 states which account for 54% of the revenue expenditure of the 19 states have budgeted a double digit growth for FY22(BE). In case of the Central government, higher spending is budgeted for interest expenses and health while lower food subsidy and outlay on MGNREGA contributed to the decline in revenue expenditure.

In case of social services, both state governments (aggregate level) and Central government have budgeted growth rates of 10% and 16% respectively. Out of the 19 states, only 2 states namely Bihar (-7.5%) and Tamil Nadu (-4.6%) have budgeted for a lower spending in FY22 than FY21.

- State governments at the aggregate level have budgeted for a growth in key heads under social services (health, education and social security). Health is estimated to grow by 9.2% in FY22(BE) for state governments compared with growth of 95% in case of the central government. Spending on COVID-19 vaccination (budgeted at Rs 35,000 crs in the Union Budget) is one of the reasons for the spike in health expenditure by the Central government.
- 10 states accounting for 50% of the spending on health have budgeted for double –digit growth under this head. However, Maharashtra (-7%) and West Bengal (-5%) have budgeted lower outlays in FY22(BE) under health spending.
- Growth in outlay on education is estimated to be in double-digits for both state governments (14%) and Centre (11%).
- In case of economic services, the states are expected to spend more by 8.9% as against a sharp decline of 17.3% budgeted for by the Central Government.
    - States like Tamil Nadu (27%) Uttar Pradesh (25%), West Bengal (123%), Madhya Pradesh (50%) have budgeted a robust growth under agriculture for FY22(BE). 56% of the states have budgeted for a growth in FY22(BE) which is more than the average for all 19 states (7.6%). Maharashtra has budgeted a 21% contraction under agriculture.
    - Under energy, state governments have budgeted a growth of 8.4% compared with a contraction of 34% for the Central governments.
- Interest expenses are budgeted to grow for both state governments and Central government to the tune of 11.7% and 15.6% respectively. For both, higher interest expenses can be ascribed to higher market borrowings in FY21 as well as elevated debt levels.

## Capital Expenditure

**Higher expenditure on asset creation in FY21 (RE) by centre and states amid deviations from budget estimates**

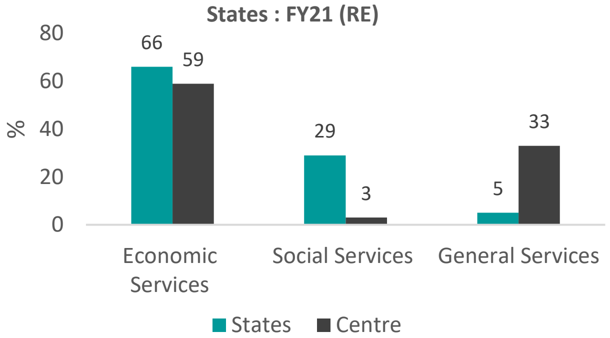
- The expenditure incurred by the centre and states towards asset creation~~,~~ essential to the future economic growth prospects accounts for 14-15% of their total expenditure.
- Capital outlay of both the central and state governments (aggregate level) in FY21, as per the revised estimates, has been higher than that in FY20. In case of the central government, the increase has been estimated to be 31% (from Rs.3.35 lakh crs to Rs.4.39 lakh crs) and for the state governments (aggregated for 19 states) it is 15% (from Rs. 3.39 lakh crs to Rs. 3.89 lakh crs).
    - Five states witnessed a contraction in capital outlay in FY21 v/s FY20. These states are Haryana (by 71%), Jharkhand (18%), West Bengal (9%), Odisha (5%) and Delhi (1%).
- There has been a significant deviation between the revised estimates and the budget estimates for FY21 at both the levels of government. The central government's capital outlay in FY21 has been 7% higher than what was budgeted, whereas for the state governments, cumulatively (nineteen states) it is estimated to be 35% lower.
    - This is significant as it means that several states have cut back on capex to remain within the FRBM norms which were extended during the year to 5%, a significant portion of which is based on meeting certain criteria (1% linked to reforms, 0.5% tied to GST compensation cess and 0.5% of unconditional borrowing). As can be seen, states spend an equivalent amount on capex compared with the centre and sharp cut- backs impacts overall capital formation in the country.
    - For fifteen states the spending towards asset creation in FY21 is less than what was budgeted, with the decline ranging between -3% to -62%. This decrease can be linked to the revenue deficit these states are faced with in FY21, except in case of Odisha, which despite being estimated to have a revenue surplus has undertaken lower than the budgeted capital outlay.
    - Nine states had budgeted for a revenue surplus in FY21 but based on their revised estimates are expected to witness sizeable revenue deficits.

- Three states i.e. Tamil Nadu, Madhya Pradesh and Uttarakhand undertook higher than the budgeted spending on asset creation in FY21 despite a widening in their revenue deficits.

**Nature of Capital Expenditure – Broad Similarities**

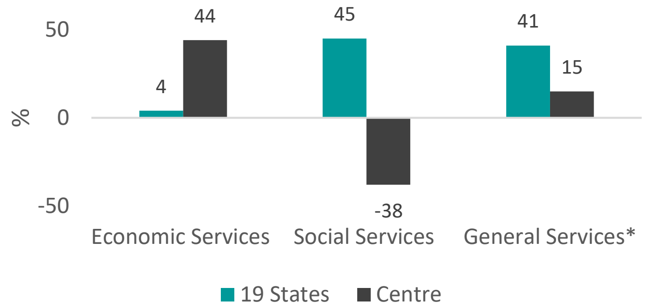
- In terms of the nature of capital expenditure, economic services accounted for the largest share both for the central (59%) and state government (66%) as per the FY21 revised estimates. This was followed by general services in case of the centre (33% share) and social services (29% share) for the states. Capital outlay towards social services by the centre accounted for a meagre share of 3%.

Chart 2: Share in Capital Outlay of Centre and States : FY21 (RE)




Source: CMIE and CARE Ratings

Chart 3: Growth in Capital Outlay in FY21 (RE) : Year-on-Year




Source: CMIE and CARE Ratings

*Non-Developmental Expenditure for States

- The central government in FY21 incurred higher expenditure on economic and general services relative to the previous year, while lowering the spending on social services.
  - The outlay towards general services (that includes defence services with a 90% share, along with police, fiscal services and so on) is estimated to grow by 15% in FY21 over FY20. It was also 13% higher than the budget estimate of FY21.
  - For economic services, the outlay as per the revised estimates for FY21 is 44% higher than that in FY20 and in case of social services it is 38% lower. Also, the expenditure on economic services is 7% or Rs.16,718 crs higher than the budgeted amount for FY21 and for social services it is Rs.10,390 crs of 41% lower.
  - Economic services outlay has been concentrated in railways (42% share) and roads & bridges (33%). Together they account for 75% of the capital outlay of economic services in FY21. In terms of growth in outlay though, spending on road & bridges is estimated to grow by 23% in FY21(y-o-y) while that for railways increased by 60%. The outlay for roads was Rs. 9,623 crs more than the budgeted expenditure, while that for railways was Rs.38,483 crs.
  - The other segments that are likely to have higher than the budgeted amounts of expenditure are special area programmes (Rs. 395 crs) and energy (by Rs. 44 crs).
  - Among the other heads of expenditure under economic services, the outlays in FY21 based on revised estimates were lower on a year-on-year basis for agriculture (-28%), industry & minerals (-13%), communication (by 15%), and science & technology (by 36%). These segments account for 6% of the outlays under economic services. There has also been a significant deviation in expenditure in these segments from what was budgeted (as highlighted in table 2). The most notable was that in the case of communications where the allocation was Rs.21,468 crs or 83% lower than the budget estimate.
  - Outlay on social services by the centre in FY21 has predominantly been towards urban development (59% share), followed by medical & public health (28% share) and housing (8% share). The capital outlay on medical & public health more than doubled in FY21 and is estimated to be 76% (or Rs.3,170 crs) more than the budgeted amount. Spending on housing too has increased by 23% over FY20 and is 13% (Rs.150 crs) more than the budget estimate. At the same time, the allocation towards urban development has been slashed by more than half.

**Table 2: Central Government Capital Outlay: Economic and Social Services**

| | % share-respective heads | % y-o-y Growth in FY21(RE) | % Deviation FY21(RE) v/s FY21(BE) |
|---|---|---|---|
| **Economic Services** | | **44** | **7** |
| Roads & Bridges | *33* | 23 | 12 |
| Railways | *42* | 60 | 55 |
| Energy | *2* | 11 | 1 |
| Agriculture & Allied services | *1* | -28 | 0 |
| Industry | *2* | -13 | -17 |
| Communication | *2* | -15 | -83 |
| Science and Technology | *2* | -36 | -42 |
| General Economic Services | *11* | 175 | -16 |
| **Social Services** | | **-38** | **-42** |
| Urban Development | *59* | **-52** | -127 |
| Medical & Public Health | *28* | 154 | 76 |
| Housing | *8* | 23 | 13 |
| | | | |

Source: CMIE and CARE Ratings

**Table 3: State Government Capital Outlay: Economic and Social Services**

| 19 States | % share-respective heads | % y-o-y Growth in FY21(RE) | % Deviation FY21(RE) v/s FY21(BE) |
|---|---|---|---|
| **Economic Services** | | 4 | -15 |
| Agriculture & Allied services | *5* | -38 | -20 |
| Rural Development | *12* | 51 | -22 |
| Irrigation | *28* | 11 | -15 |
| Energy | *8* | -34 | -24 |
| Industry | *1* | 70 | -35 |
| Roads & Bridges | *38* | 7 | -4 |
| **Social Services** | | 45 | -18 |
| Education, sports & arts | *12* | 29 | -34 |
| Medical & Public Health | *17* | 64 | -5 |
| Water supply & sanitation | *34* | 53 | -12 |
| Housing | *8* | 126 | -19 |
| Urban Development | *18* | 33 | -19 |

Source: CMIE and CARE Ratings

- The state governments in FY21 by and large incurred significantly higher capital outlay on social services from that in the previous year and either scaled back or saw a limited rise in spending on economic services.
  - At the aggregate level, social services expenditure grew by 45% in FY21 over FY20, while the increase in capital outlay towards economic services was restricted to 4%.
  - Despite the increase of an annual basis, the outlay for social services was 18% or Rs.25,339 crs less than the budgeted spending for FY21. Similarly, for economic services it has been lower by 15% or Rs. 44,316 crs.
  - Social services capital outlay of states has largely been towards five key segments i.e. water supply & sanitation (34% share), followed by urban development (18%), medical & public health (17%), education (12%) and housing (8%). All these segments are estimated to see a notable increase in annual allocation in FY21 despite it being lower than the budgeted amounts (Table 3).
  - In the case of states too, economic services outlay was primarily towards roads & bridges (38% share). The other major heads of outlay are irrigation (28% share), rural development (12%) and energy (8%). These heads together account for nearly 80% of economic services expenditure. In terms of increase in outlay in FY21 (y-o-y), spending on road & bridges was higher by 7%, irrigation by 11% and rural development by 51%. Allocations towards energy by states is 34% lower in FY21.
  - The allocation to the various heads of economic services in FY21 was lower than the budgeted amount with the deviations in the range of -4% to -35% (Table 3).

**Centre and States focussed on asset creation in FY22**

- The centre as well as the states have budgeted higher expenditure towards asset creation as denoted by the capital expenditure in FY22. The 19 states have cumulatively budgeted for a 33% growth in capital outlay (from Rs. 3.89 lakh crs to Rs. 5.16 lakh crs) in FY22 over the revised estimates of FY21, while the growth in the centre's capital outlay is estimated to be 26% (from Rs. 4.39 lakh crs to Rs.5.54 lakh crs).
- The focus of capital outlay for the government (centre and state) is on economic services. The centre's allocation towards economic services is estimated to increase by 37% in FY22 (to Rs. 3.5 lakh crs) while that of the 19 states analysed is to increase by 28% (from Rs. 2.56 lakh crs to Rs.3.27 lakh crs).
- The spending on social services by the states is budgeted to be 43% higher (at Rs.1.59 lakh crs) than that in FY21(RE). The central government's expenditure on this segment is estimated to be Rs.0.28 lakh crs in FY22. Clearly, states are more involved in building social infrastructure relative to the centre.
- The centre's capital outlay towards general services (viz. defence services) is estimated to grow by 5% in FY22 (to Rs.1.5 lakh crs).
- Nearly all the other major segments of economic services of the central government are budgeted to witness a sharp increase in capital outlay in FY22.
  - Railways is budgeted to see the highest allocation towards asset creation of Rs.1.06 lakh crs, which is marginally lower (by 1%) than the allocations of FY21. This is closely followed by the expenditure on roads & bridges at Rs.1 lakh crs (16% increase over FY21). Both these heads of expenditure are estimated to account for nearly 60% of the outlay of economic services.

        - Special area programmes and science & technology too are slated to receive higher allocation of 27% and 77% respectively in FY22 over the revised estimates of FY21.
        - In case of social services, the capital outlay is geared towards urban development with allocation to the segment budgeted to increase by 168% (to Rs.23,322 crs) from the revised estimates of FY21.
    - The state governments economic services capital outlay for FY22 has been budgeted to increase by an average 24% over FY21 across all the major heads of expenditure viz. agriculture, rural development, irrigation, energy, industry, and roads & bridges.
        - Roads and bridges continue to account for the largest share of allocations (of 38%) and are estimated to see a 28% increase in expenditure.
        - Allocation towards irrigation is slated to increase by 28% and for rural development by 20%.
        - The capital outlay towards the main heads of social services of the 19 states are budgeted to see an average increase of 40% in FY22 over FY21. Water supply & sanitation would receive the highest allocation (44% increase to Rs.0.55 lakh crs) followed by medical & public health services (53% growth to Rs.0.28 lakh crs) and urban development (rise of 30% to Rs. 0.26 lakh crs)

**Key Takeaways:**

**FY21**

- The pandemic year FY21 has been characterised by higher expenditure by the central and state governments.
- Revenue as well capital expenditure has grown in FY21 over FY20 at both the levels of government.
- There have been significant deviations between the revised estimates and budget estimates of expenditure for FY21 for the central and state governments. These is a noticeable difference between the two levels of the government. The revised revenue expenditure estimates for FY21 for the state governments (at the aggregate level) was lower than the budget estimates (by 4.5%), while it was higher in the case of the central government (by 14%)
- The increase in the central government's revenue expenditure is mainly on account of the spending towards higher food subsidies and increased spending on social security schemes.
- Most states faced with a revenue deficit have cut-back their spending on asset creation from what was initially budgeted for FY21 (by 35%). On the other hand, the central government's capital expenditure is higher than the budgeted amount (by 7%).
- The centre and state governments have been incurring higher capital expenditure on economic services viz. roads and bridges.
- The state governments have also been incurring capital outlay towards social services viz. water supply & sanitation, medical & public health, urban development, housing and education. Spending (capital outlay) on medical & public health doubled in FY21
- The central government's capital outlay towards social services is limited (5%) and is geared towards urban development. A sizeable portion of its capital expenditure is towards defence services (around 30%).

**FY22**

- For FY22, both the centre and state governments have budgeted higher expenditure towards asset creation.
- For the centre it is mainly towards railways and roads and bridges.
- In case of states it is primarily towards roads followed by irrigation and rural development.

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