Budget 2023: Sustaining private investment should be a priority

Also, the budget needs to address pressing concerns over unemployment, inflation, rising inequalities in income and wealth, growing concentration in industry and distress in the MSME sector

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With the Indian economy getting back on to a 6-7% GDP growth rate trajectory post-pandemic, it is quite apparent that some of the major challenges to staying on course are and will continue coming from the global environment that are mostly beyond our control. These factors include the persistence of elevated inflation rates globally, the continued hawkish stand of the US Fed on interest rates, the imminent recession in the US and other major economies including Europe and China, the ongoing Ukraine-Russian war, and a trend towards greater protectionism worldwide, posing hurdles to our present growth trajectory. There is little that the Indian government's budget can directly do to counter these issues.

With exports likely to see a decline on account of external factors, the drivers to growth must come from within. Private consumption has grown strongly in 2022; however, according to NSO estimates it is expected to contract in the first half of FY 2023, which means a greater dependence on private sector investment growth and/or government spending including its revenue and capital expenditures.

While bank credit growth rates accelerated since January 2022, there are signs that growth is waning since November 2022. Moreover, bank credit growth includes demand for consumer loans and cannot be taken to only mean an uptick in private sector investment spending. With capacity utilization rates still hovering at 75 percent, the actual growth in private sector investment spending will be a key determinant of the Indian economy's growth rate in FY 2023 as well as robustness of its growth path in the longer term. Perhaps the greatest challenge in many countries across the world is the secular decline in private sector investment. Investment is essentially based on expected demand and as long as the bouts of crises that the world has experienced continue, it is unlikely that private investment demand will witness a robust rebound. It is important that the budget addresses this issue and provides a clear plan to enhance private sector investment, not merely a one-time boost but a more sustained increase.

Over the last decade and a half, particularly since the 2008 global financial crisis (GFC), government fiscal deficits have been the crucial stabilizing force in almost every country. While the US fiscal deficit rose up to 10% in the aftermath of the GFC, it increased to 15% of GDP during the Covid-19 crisis. India's consolidated fiscal deficits also breached 10% of its GDP to ensure the implosion of its economy, particularly during the pandemic. The role of the government's deficit is not simply to enhance aggregate demand to maintain consumption but more importantly, by doing so, it also sustains private investment growth as the it irons out to a significant degree the uncertainties that decision-makers face in a globalized world.

Given that these uncertainties continue to dominate the global landscape, it is essential that the government's budget for FY 2023 does not deviate from its stabilization role to instead focus on fiscal consolidation as an end in itself. This will be especially challenging in a scenario where inflationary pressures are still high at more than 6% and the current account deficit widening to 3% of GDP. Nonetheless, if India has to sustain its growth trajectory, let alone moving to a higher one, it is imperative that government spending supports aggregate demand that induces sustained private sector investment.

Many economists as well as international rating agencies have already started a debate on fiscal deficit numbers thereby exerting pressure on the government to rein in its deficit. The increased tax buoyancy is also taken to mean that the economy is now back on track so that the government can begin curbing its spending. This, however, ignores the fact that tax collections could itself be a function of government spending so that a cutback on the latter may cause the former to falter.

Budget debates are usually centered around macroeconomic indicators like GDP growth rates and the fiscal deficit. However, the budget is at the same time, and perhaps more importantly, a statement of the government's macroeconomic priorities. It will be interesting to see how and to what extent it addresses some pressing concerns over unemployment, inflation, rising inequalities in income and wealth, growing concentration in industry and distress in the MSME sector.

Another subject that the budget must bring more aggressively into its purview are measures to counter the effects of climate change that are becoming more regular and more intense. A case-in-point is the severe heat wave which struck northern India, adversely affecting agricultural output. While central banks are already fearing the effects of climate change on the quality of collateral assets held by commercial banks and the possibility of financial instability thereof, governments must consider broader contingencies that could emerge from natural disasters. Ad-hoc measures may no longer suffice in tackling the catastrophic impacts of climate change.

Perhaps the subject most neglected in any formal macroeconomic analysis is the informal sector, which even today gives employment to around 85% of India's working population. Estimates of GDP usually consider the informal sector to be a proportion of the formal sector and therefore, positive growth in the formal sector translates to an equal growth rate of the informal sector. However, the informal sector has been under severe stress – as evidenced, for instance, by the sharp decline in rural wage growth – but at the same time, continues to provide employment to the masses. GDP growth rates and even growth in private investment, which is increasingly capital as well as highly skill-intensive, is unlikely to absorb India's massive unskilled labour force. Many state governments are experimenting with the idea of urban job guarantee schemes. Support for such initiatives by the central government in addition to MNREGA could be a game-changer for India's informal sector.

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