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Government Expenditure in India (2024-25): Development, Structure, Dynamics of Defence, and Developmental Implications

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ABSTRACT

The key tool of governments to implement the policy priorities is the public expenditure. The nature of government spending in India and its direction dictates the rate of growth and inclusiveness of the Indian economy, quality of government facilities and ability of the nation to ameliorate the security challenge. In this article, the development and form of the government spending in India is analysed based on the fiscal-year budget reports and macroeconomic indicators (FY2023-24 final and Budget Estimates FY2024-25). It brings out three central themes namely (1) the gradual increase in social and capital expenditure, (2) the on-going high-profile and modernization-driven growth of defence expenditure, (with a sharp increase in capital spending on acquiring equipment), and (3) the fiscal trade-offs that limit financing of development, (particularly the balance between revenue commitments and the fiscal deficit target). Basing on the official budget documents, economic surveys and government press releases, the article concludes with the policy recommendations to shift the expenditure towards greater quality capital formation without compromising the macro-fiscal stability and defence preparedness.

Introduction

The decision making in government expenditure determines the path of development in a nation. In the case of India, and to a growing number of other economies, the issue is not whether the state spends, but on what, how it funds such spending and how efficiently it does so. Over time, since the 1990s, there have been changes in the budgetary make-up in India; as the social sectors (health, education, rural development) and capital expenditures have grown in relative and absolute terms, the compulsory revenue outlays (especially payment of interest, pensions and some subsidies) demand a large proportion of budget. Defence expenditure is still an important part of the central government expenditure and in recent budgets has been given preference in capital modernization.

Review of Literature-

- **Wagner, A. (1883).** Three extracts on the monetary finance. Classics in the theory of public finance, R. A. Musgrave and A. T. Peacock (Eds.). London: Macmillan. Wagner postulated that the government spending grows as the economy grows. Public responsibilities intensify with industrialization and the increase in income, which is why the expenses of the state expenditures in developing economies, such as India, increase over time.
- **Peacock, A. T., & Wiseman, J. (1961).** The development of the state spending in the United Kingdom. Princeton University Press. Peacock and Wiseman came up with the displacement effect which asserts that crises permanently increase the level of spending among the people. Their theory gives us the structural increments in defence spending and welfare spending.
- **Musgrave, R. A. (1959).** Theory of public finance: a study in public economy. McGraw-Hill. The functions of government were identified as allocation, distribution and stabilization by Musgrave. His model warrants state spending in the attempts to address market failures, decrease inequality, and enhance economic stability.
- **Barro, R. J. (1990).** A plain simple model of endogenous growth government spending. J.Political Economy, 98(5), S103-S125. Barro proved that efficient government spending stimulates the growth in the long run. Nonetheless, an unproductive spending can put the economy into overburden, crowding out the private investment and efficiency.
- **Benoit, E. (1978).** The developing nations in terms of growth and defense. Economic Development and Cultural Change, 26(2), 271-280. Benoit studied defence spending in developing countries, which indicated that moderate military spending could boost growth, but high spending could not lead to development spending.

General trends in government spending (amounts and proportions)

- **Total size of government expenditure**

The general government expenditure as a proportion of the GDP in India has bounced back once the COVID-related spike and is projected to remain at about 10-11 percent of GDP in recent years (general government spending as consolidated central plus state outlays). According to global datasets, in 2024, the government expenditure of India is estimated to be about 10.1 percent of the GDP, which is sufficient when comparing it with developed economies but lower than most emerging economies that maintain high levels of the government footprint.

Two implications follow, First, India can increase the volume of high-quality public investment provided that it is possible to mobilize domestic resources and reduce fiscal expenditures. Second, the overall spend-to-GDP ratio is relatively low, indicating that prioritization decisions at the centre and at the states are heavily leveraged over development results.

- **Deficit goals and fiscal policy**

The recommended fiscal consolidation objectives in the Union Budget 2024-25 allowed direct capital expenditure. In FY2024-25, the central government unveiled a fiscal-deficit target of about 5.1 percent of GDP (BE) and said it would reduce the deficit to about 4.5 percent over the next few years--a high but economically sound consolidation route in the face of increased capital requirement and as the world becomes uncertain.

This fiscal policy forms expenditure limits and room to capitalize. Recurrent shortfalls necessitate borrowing which may either crowd out the private investment or increase interest burdens until they are compensated by growth and revenue buoyancy.

Make up of expenditure: revenue commitments and capital and social spending

- **Revenue (current) expenditures: clingy obligations**

The major portion of annual expenditure is made up of the revenue expenditure; salaries, pensions, subsidies, interest payments, and upkeep. One such huge and recurring expense is interest payments, which, as a percentage of GDP, have been fluctuating at 3.0-3.5 per cent over the past years and therefore has been occupying a significant part of revenue receipts. Interest payments that are high lower the flexibility of the fiscal. Economic Survey and budget tables emphasize the maintenance of these obligations.

Subsidies (food, fertilizer, petroleum) and defence pensions - both political (sensitive) and economically (large). However, subsidies experienced a headline reduction following FY2022-23 due to reduced energy/fertilizer subsidies and direct-targeted transfers, which liberated some immediate space to other priorities.

- **Capital spending: the driver of development**

Capital outlay- government spending on roads, rails, utility, and defence equipment (capital head) and on government enterprises- has been the major government instrument to maintain a potential of growth in the medium term. Budget 2024-25 prioritised more capital expenditure, which included large funding to the states on infrastructure through long-tenor and interest free loans undertaken by the centre, the aim which is to enhance the public capital stocks. The given goal was to crowd-in investment by the privates and trigger growth.

Simultaneously, the capital spending structure is important: productive infrastructure (ports, power, digital connection, water, climate resilience) will give growth payoffs. There is empirical evidence that the marginal returns to well-oriented public capital are still high to support growth and employment goals of India.

Defence spending: size, organization and modernization

- **Size and recent trends**

The defence budget has been a large central government expenditure, which has been steady in India. In the case of FY2024-25, the budgetary allocation of the Ministry of Defence (without considering pensions) had been fixed at a huge amount; the combined defence expenditure (including defence pensions) amounts to over INR 6.2 lakh crore- a year on year growth and the highest nominal expenditure any budget has allocated to the sector in the last few years. The capital head allocation to defence was also increased by the government to enhance modernization and bridging gaps in capabilities with capital allocation to FY2024-25 (equipment acquisition) being explicitly pointed out at approximately INR 1.72 lakh crore in government statements, although higher than the previous years.

These trends are indicative of a twofold process: (a) strategic-security needs in the changing environment of the region and (b) a long-term change in the ratio of revenue (personnel, maintenance) to capital modernization (platforms, munitions, electronics).

- **Defence as a share of GDP**

Defence spending in India has varied around 1.0% in the last ten years as a proportion of GDP- less than that of most other nations enjoying an active security environment (2 percent of GDP is usually seen as a sustainable amount) but large in absolute rupee terms, because India is a large economy. The tables of Economic Survey show the defence spending as a stable proportion of central receipts and GDP, limited but given a priority.

- **The modernization focus: capital vs revenue in defence**

One has been the increased trend to capital outlays (platform acquisition, R&D, networked defence), which increased more rapidly than revenue outlays over the past budgets (especially FY2024-25 when capital spending increased by double digits in BE terms). This is significant to modernize capability with two fiscal implications:

Capital acquisitions are only once but may need a long life-cycle maintenance and operation costs in future years (increasing revenue spending).

Huge capital investments, which are partly based on the capacity of the domestic industry, entail predictable budgetary allocations to prevent project slippage and budget overrun.

- **Pensions and contingent liabilities Defence**

Pensions and long term commitments (such as the contingent liabilities of defence public sector undertakings and guarantees) are significant and have to be included in any medium term fiscal system. The strength of structure of the pension bill and accruals of the past increases with the force structure; the financially prudent step is actuarial reform and progressive funding solutions.

Developmental consequences of existing expenditure pattern

The existing balance of the public expenditure has a number of development-relevant results and conflicts.

- **Positive outcomes**

Increased capital expenditure (also on infrastructures) enhances productive potential and investment by the private sector, helps to deal with supply-side restraints, and linked-in connectivity. The capital formation focus and the state-level borrowing to fund capex of the 2024-25 budget are indications that the public capital is a key growth factor.

The regular social-sector expenditures (health, education, social protection) still cushion the vulnerable groups and accumulate human capital. Recent budgets reveal that there are incremental improvements in major welfare programs and schemes.

- **Constraints and trade-offs**

The discretionary spending is inhibited by fiscal inflexibility due to revenue commitments (interest payments, pensions). An increase in interest payments, which cannot be counteracted by the revenue buoyancy in growth, reduces fiscal available space to capital expenditure.

Defence-modernization vs. social/capital trade-off: more defence capitals increase the strength of national security and leads to a smaller marginal fiscal space to fund other capital investments, unless the extra revenue or re-prioritisation. The defence spending political economy usually renders it less contestable as compared to other budget heads.

Subnational fiscal demands: states fund a significant portion of the provision of the public goods (health, education, the development of the local infrastructure). The nature of the relationships between expenditure and outcomes-centre-state fiscal transfers and schemes can limit the discretion of states.

- **Cost effectiveness and quality of spending**

More valuable than the mere magnitude of expenditure is quality, which can be understood as selection of the project, efficiency of procurement (especially in the defence sector), maintenance of assets and social-outcome orientation attitude. Poorly planned or implemented capital spending has low returns and may even crowd out operating expenditure in important services.

The macro-fiscal forecast and risks

- **Growth and revenue buoyancy**

The macro outlook in India -high growth forecasts in FY2024-25 and other future years provides a favourable fiscal consolidation and increased capital expenditure environment. The growth of the nominal GDP contributes to the buoyancy of revenue and the government may apply it to increase the development spending without disrupting the deficit trajectory.

- **Extrinsic shocks and interest-rate shock**

Nonetheless, volatility in the world (shocks in commodities, turmoil in financial markets) may raise the cost of borrowing, expand deficits and decrease fiscal space. High oil prices or trade shocks may have the effect of increasing subsidy requirements and reducing fiscal space.

- **Contingent liabilities and off-budget risks**

Public enterprises, guarantees, and project contingent liabilities can put pressure on public finances when their existence is not transparently disclosed and controlled. An example of contingency cost that may be exposed is defence procurement delays and cost increase.

Policy recommendations

In order to balance between defence requirements and development necessities without compromising fiscal sustainability, the following recommendation in this paper is:

- **Re-prioritise capital expenditure on high productivity**

Increase the share of capital budgets on those projects that have quantifiable economic benefits (transport corridors, modernization of power distribution, water infrastructure, digital connectivity, climate-resilience projects). Strict economic assessment should be used as the driving force of prioritization.

- **Improve the quality of revenue and expand the base**

Maintain the sustainability of revenue by ensuring better tax compliance and broadening as well as widening of non-tax revenue (user charges on some of the services provided to the people in the society where they are fair). This lessens the dependence of development projects on a deficit financing approach.

- **Reform in defence procurement and local industry**

Make defence procurement leaner to decrease cost overruns, establish domestic defence production (Make in India), and make sure that long-term maintenance costs are estimated at the time of approval. This will maintain capacity and reduce fiscal shock.

- **Reforms of pension and subsidy- target and sustainability**

The leakages will be constrained by pension reform (gradual actuarial accounting, reserve funds where possible) and better targeting of subsidies through direct transfers, which will give them a free fiscal space in which to invest.

- **Enhance management of public-investment**

Implement capital-project multi-year-budgeting, enhanced project-selection criteria (cost-benefit analysis) and separate project-monitoring departments to enhance the rate of project execution and decrease project delay.

- **Fiscal cooperation at the centre state level**

Implement state capital formation using incentivised loan schemes (like the 2024-25 budget) but combine it with capacity-building to prepare and implement projects on the state level.

Conclusion

India is at a cross-road where prudent state expenditure can usher in the sustained inclusive growth. The balance sheet between growth facilitation and fiscal prudence is reflected in the 2024-25 budgetary position - which is marked by increased capital outlays, more defence modernization allocations and a realistic medium-term consolidation goal. Nevertheless, the long-term growth results will be less related to headline allocations and more to the structure, quality and predictability of the expenditure: the increased emphasis on productive capital formation, the challenge of budgeting stiffness (interest payments, pensions), and the efficiency of defence procurement. Provided that India can tap revenue buoyancy to fund high-payoff social investments, and to control fiscal risks, the nation will be able to continue growing, to boost national security, and to hasten the growth of human-capital, an outcome impossible to fully explain by aggregation of expenditure but achievable by smart policy and institutional reform.

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