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Pre-Budget Analysis 2025-26

Ankur Singh, Aditi Verma, Bilash Dey, Sarthak Ojha, Theresa Jose

Introduction

India’s economic growth in the second quarter of the last financial year slowed to 5.4% with the economy grappling with sluggish capital formation, weakening consumer demand and the ripple effects of adverse weather conditions.

This year’s budget is expected to attract both foreign and domestic investments to improve public health infrastructure among other critical sectors.

Areas Covered

This pre-budget analysis delves into three broad areas of focus shaping the country’s economic outlook

1. Navigating Fiscal Fedralism
2. The Capex Conundrum
3. Balancing Capex with Welfarism

Federalism in Flux: Balancing the Union-State Dynamic

Cooperative federalism refers to the horizontal relationship between the Centre and the States, where they cooperate in the larger public interest. This approach encourages States to actively participate in the formulation and implementation of national policies.

GST and Fiscal Challenges

- GST Revenue Growth: Since its implementation, GST collections have not met the promised growth rate. The average monthly growth rate from April 2022 to October 2024 was only 0.86%, contrasting sharply with the promised 14% annual growth in state revenue.
- End of Compensation Mechanism: The compensation mechanism ended in 2022, creating fiscal constraints for many States and exacerbating financial difficulties.
- Reduction in Fiscal Autonomy: With the imposition of GST, States ceded approximately 44% of their taxation rights, reducing their ability to adjust tax rates to align with their economic conditions.
- Revenue Disparity Among States: According to a National Stock Exchange report, inter-state revenue disparity is critical:
    - States like Telangana, Karnataka, Jharkhand, and Uttar Pradesh show growth.
    - States like Himachal Pradesh, Assam, Mizoram, and Meghalaya exhibit slower revenue growth, with minimal or contracting revenue receipts in FY25.

Economic Overview: India experienced promising GDP growth of 8.2% in FY24 but faced a slowdown in Q2 FY25 at 5.4%. Manufacturing and mining sectors saw sluggish or negative growth.

Infrastructure Focus: The government continues to prioritize infrastructure, with sustained physical capital expenditure being crucial for economic recovery.

Global Challenges: Despite global headwinds, economic activity encountered unpredictable slowdowns, emphasizing the need for strategic domestic "heavy lifting."

Current Account Deficit: Widened to 2.8% of GDP in Q3 FY25, surpassing the projected 2%, reflecting challenges in net exports.

Fiscal Health: Fiscal deficit reduction efforts have improved the quality of the fiscal state, with revenue expenditure contained.

Consumption Trends: Awaited data on festival and wedding season consumption underscores the importance of equitable growth for the middle class.

Capex Conundrum

- **Massive Infrastructure Investment Plan:** India's National Infrastructure Pipeline (2020-2025) proposes investments of ₹111 lakh crore (US$1.4 trillion), focusing on energy, roads, railways, and urban development.

- **Record High Public Capex**: The government has set a historic infrastructure spending target of ₹11.11 trillion for FY 2024-25, accounting for 3.4% of the GDP.

- **Slow Growth in Private Investment:** While public investment remains robust, private capital expenditure has lagged, raising concerns about sustainable growth driven solely by public funds.

- **Declining Investment Demand:** Gross Fixed Capital Formation (GFCF) as a share of GDP is expected to decrease from 30.8% in FY24 to 30.1% in FY25, with investment demand growth slowing to 6.4% from 9% over the same period.

- **Employment Generation Gaps**: Despite increased spending, unemployment remains a concern, with rates rising to 9.2% in June 2024 from pre-pandemic levels of around 6%.

- **Implementation Bottlenecks and Fiscal Risks:** Delays in project approvals, land acquisition, and execution, coupled with fiscal constraints, pose risks to effective fund utilization and economic stability.

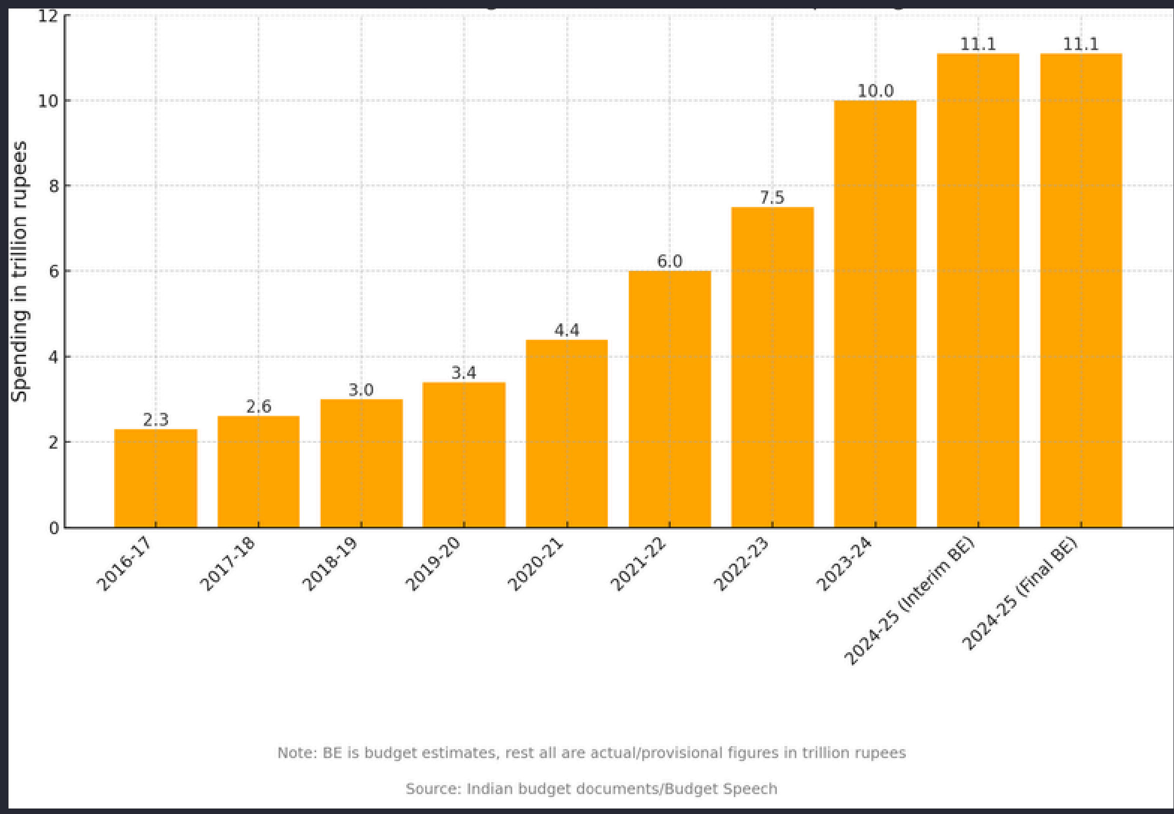


Figure 1

Sectoral chasm

- **The <u>agriculture sector's</u>** contribution to India's GDP has shown a gradual decline, from 20.3% in 2020-21 to 18.3% in 2022-23, indicating a structural shift towards other sectors with a historically 2-4% annual growth rate and uneven growth across states. Primarily driven by Animal Husbandry & Dairying and not by crops. By 2023-24 this allocation had increased more than fourfold to ₹1,31,612.41 crore.

- **The Union Budget 2024-25 allocated** ₹1,32,469.86 crore to the agriculture sector, marking a 4.58% increase from the previous year's revised estimates. This <u>increment</u> focuses on enhancing productivity in pulses, oilseeds, and implementing digital crop surveys. Despite the nominal increase, the share of the agriculture ministry in the total budget has been declining. In 2022-23, it was 3.36%, which reduced to 2.74% in 2024-25, indicating a relative deprioritization of the <u>sector</u>.

- **The <u>agriculture credit</u> target** was raised to ₹20 lakh crore in the 2023-24 budget, with a focus on animal husbandry, dairy, and fisheries, representing an 11% increase from the previous year. Despite increased credit, top <u>Indian private lenders</u> have reported a rise in farm loan defaults due to a weak rural economy, unpredictable weather, and rising agricultural costs, leading to delayed repayments among farmers.

- **<u>Experts recommend</u>** adopting a cluster approach for implementing agricultural schemes to address challenges across the crop value chain more effectively, suggesting that focused diagnostics can lead to better execution and impact. The <u>2024-25 budget</u> includes a $24 billion expenditure plan aimed at creating jobs over the next five years and increasing rural spending, balancing welfare spending, capital expenditure, and fiscal discipline.

- The same goes with India's education system, ambitious policy goals coupled with systemic inequities and consistent chronic underfunding of around 3% of GDP fall starkly short of the 4-6% benchmark recommended globally. The allocation, although increased, is not the percentage of GDP, even the percentage.

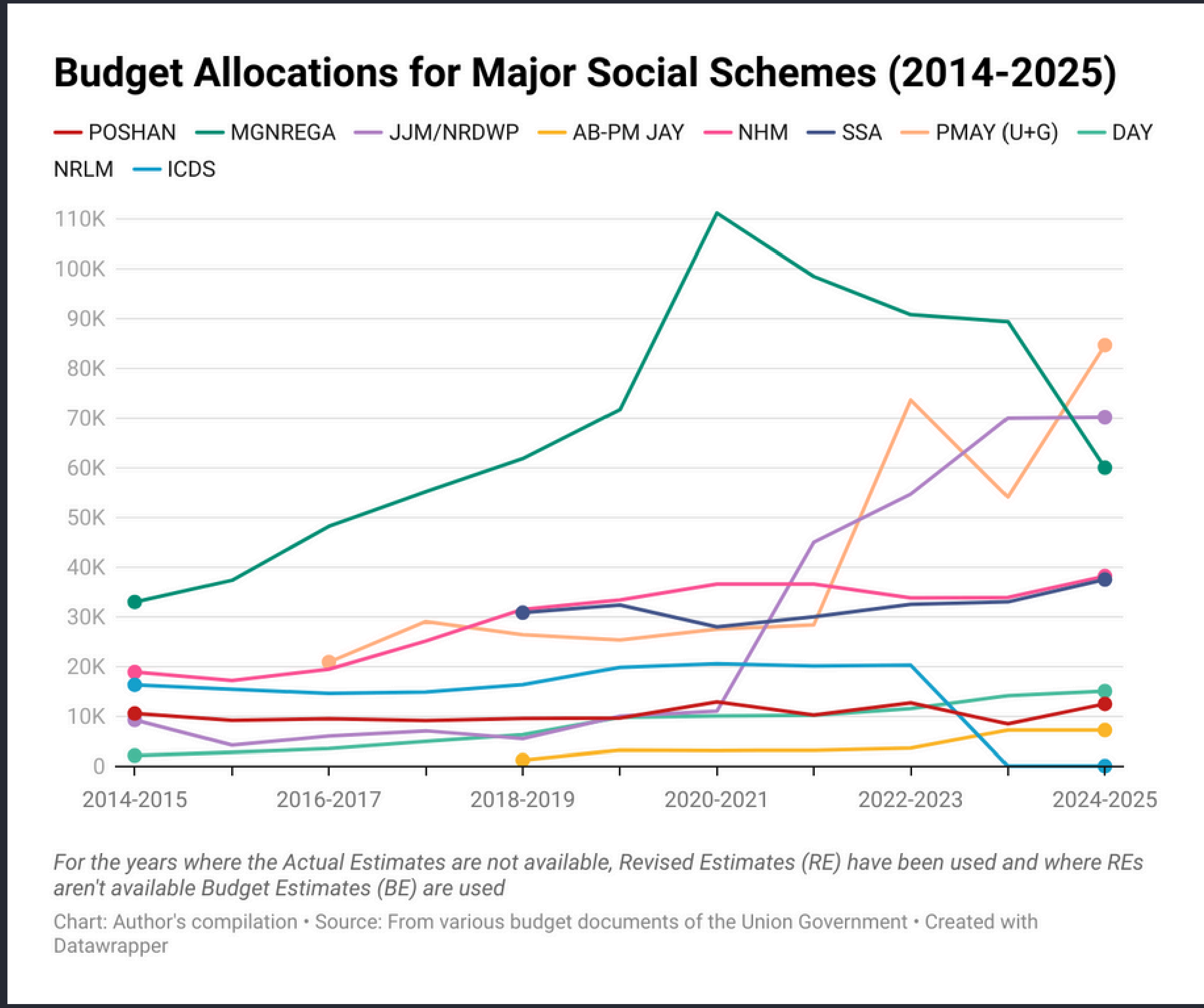
- The abysmally low investment in the public healthcare sector is a systemic inertia. The health care market is predominantly dominated by hospital industry (70%) followed by pharmaceuticals (20%). Being the leader at G20 for a year yet the lowest when it comes to public healthcare spending among G20 nations barely 1.28% of GDP taking us more distant in dreaming of Universal Health Coverage.

- **The Doctor-to-patient ratio** is skewed while western and southern states on average have 15 doctors per 10000 population, it is barely on average with the northern states, 4 doctors per 10000 population creating health desserts for remote and underserved areas.

- **The National Health Policy (NHP) 2017's** ambitious targets were met with incremental spending increases, but still insufficient to meet its goal of 2.5% GDP healthcare spending by 2025 suggesting that budgetary increases remain reactive rather than proactive. Budgetary allocations should focus more on primary care as it is the most underfunded sector with less than 15% of the budget with a preventive care approach.

Safety Nets in Free Fall

- **Economist <u>Thomas Piketty's 1995</u>** paper has underscored the importance of redistributive policies in enhancing social mobility and reducing inequality. In the Indian context, effective redistribution through progressive taxation and social welfare spending is crucial for addressing disparities.



- **<u>Analyses</u> indicate** that allocations for key social sector schemes have either remained stagnant or declined in real terms. For instance, the allocation for the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS) was reduced by nearly 32% in the Union Budget 2023-24 compared to the previous year. Such reductions can undermine the effectiveness of these programs.

- **In the Union Budget for the <u>FY 2023-24</u>,** the allocation for food subsidies was set at ₹2.05 trillion, which represents a 3.34% decrease from the revised estimate of ₹2.12 trillion for the fiscal year ending March 31, 2024.

- **The Saksham Anganwadi and POSHAN 2.0 scheme,** which encompasses ICDS, was allocated ₹20,554 crore in 2023-24, marking a marginal increase of 1% from the revised estimates of 2022-23. This allocation is lower than the combined allocations of the schemes it subsumed in previous years, indicating stagnation in funding. These budgetary decisions have significant implications for nutritional outcomes, especially for children under six years of age, as they may affect the effectiveness of programs designed to combat malnutrition and support child development.

- **Allocations for welfare schemes targeting Scheduled Castes (SCs)** were reduced by 27.9%, from ₹9,409 crore in BE FY24 to ₹6,780 crore in RE FY24. Similarly, welfare schemes for Scheduled Tribes (STs) saw a 23.5% reduction, with allocations decreasing from ₹4,295 crore to ₹3,286 crore. Fewer resources lead to exclusion from opportunities that foster social mobility, perpetuating cycles of poverty and inequality. A report indicated that India's income inequality in 2023 remained higher than in the 1950s, with the Gini coefficient at 0.410 in 2023, up from 0.371 in 1955.

- The phenomenon of renaming schemes without significant changes has been noted in several instances. For example, the LPG connection scheme was originally known as the "Pratyaksh Hanstantrit Labh" (PAHAL) scheme during the UPA government and was later renamed to "Pradhan Mantri Ujjwala Yojana" (PMUY) under the current administration, but the core structure remained largely the same.

- Recent data underscores the persistence of inequality, with the K-shaped recovery noted by Nomura indicating a widening gap between high-income and low-income households. While higher-income groups are benefiting from asset appreciation and easier credit access, middle- and lower-income groups continue to grapple with high inflation and limited disposable income. This disparity has further stressed rural demand, with FMCG sales in rural areas declining.

- **Youth unemployment** remains a pressing issue in India, with rates reported between 10-13%. This persistent unemployment among the youth poses challenges to economic growth and social stability. According to the "State of Working India 2023" report by Azim Premji University, 42.3% of graduates under the age of 25 are unemployed. This statistic underscores the challenges faced by young graduates in securing employment that matches their qualifications, highlighting a significant issue in the Indian labor market.

For inputs, comments or clarifications please contact The Centre for New Economics Studies at

cnes@jgu.edu.in