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Theoretical Perspectives of Public Expenditure in India.

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Abstract:
The paper aims to study the importance of public expenditure in economic development of developing countries like India. In this direction, a paper attempts to study the theoretical perspectives which have been drawn from various studies signifying the importance of social economic services for development goals of developing countries. However the analysis and findings of various studies pertaining to the pattern & composition of public expenditure of government of India pointed towards the fact that Public Expenditure is not supporting to capital formation a key to economic development.
Keywords: Public Expenditure, Social Economic services, Capital Formation, Economic Development.

Introduction and Theoretical Background

Historically public finance has not given much importance to public expenditure. This is because the classical economists had a firm believe in policy of "Laissez-faire" as such during 18th and 19th century functions of the states (Govt.) were only of regulatory nature such as:- maintenance of law and orders, defending against external aggression and running public utility services, "Adam Smith" the founder of classical economics advocated that government expenditure was normally as a waste and by supporting 'Sir Henry Parnell", he asserted that, "Money would fructify more in the hands of the people than in those of the state or every particle of expense that is incurred beyond what is absolutely required for preservation of social order and for protection against foreign attack is waste and unjust and oppressive imposition upon the public". Thus, during 18th and 19th century public expenditure remained neglected.

However, Adolf Wagner, a famous German fiscal theorist of 19th century, unlike classical English economists had propounded now much famous, "law of increased activities of state" in these terms, "comprehensive comparisons of different countries and different times shows that among progressive people with which alone we are concerned an increase regularly take place in the activity of both the central and local governments. This increase is both extensive and intensive; the central and local governments constantly undertake new functions, while they perform both old and new functions more efficiently and completely". The basic gist of this law in simple words highlights functional cause and effect relationship between growth of an economy and relative growth of public sector in other words it shows a positive proportional relationship between economic development and public expenditure. According to this law of Wagner scope of government activities would continue to increase both absolutely and relatively to national income for many years into the twentieth century and this would be the natural result of economic growth and the continued pressure for social progress because economic development carries with it larger population and larger needs for urbanizations and technical change etc. which may call for increased government activity. Further economic development also means a greater division of labour, the rise of larger business organization, and in general a more complex set of economic relationship among people. It is not unreasonable to expect a rise in government activity.

But however, it was 20th century that marked a turning point and brought a new revival in the concept of public expenditure. Say's law of market one of main standing pillar of classical economics, the basic gist of which states that, "supply creates its own demand was falsified by the onslaught of the "Great Depression" of 1930s. Whereby automatic adjustment mechanism of classical's failed to uplift the economy from the clutches of depression under these circumstances "J.M. Keynes appeared with the penetrating analysis and asserted that the basic cause of the ills of a developed market economy was the deficiency of effective demand which was caused on account of low marginal propensity to consume coupled with a low marginal efficiency of investment. He, therefore, advocated a continuous injection of additional purchasing power in the market through stimulation of investment and consumption activities and through direct public investment. This direct investment was a part of the public expenditure. Such a public expenditure was meant to directly add to the effective demand in the market and generate a high-value multiplier by distributing income to those sections of the population which had a high marginal propensity to consume. The addition to demand by such sections would also stimulate investment activity and thus, through an all-round increased demand, the depression could be overcome. It is to be noted that though basically Keynesian prescription was directed towards curing a state of depression. But the logic of the argument can also be extended to that of curing an inflationary situation. Thus, it is argued that Keynes was the first to formulate convincingly that, "the govt. has not only ability but the responsibility to use its power to increase production incomes and jobs."

With this recognized and proved importance of public expenditure, in a period following great depression and particularly of World War II there has been extensive and intensive increase in activities of states consequent upon which there had been upward trends in public expenditure in all countries exactly consistent with Wagner's hypothesis. For instance: in USA in 1975 it expenditure as a percentage of GDP was 35.1% in Germany for the same period of public expenditure GDP ratio was even greater than USA as it was again great than that of Germany USA i.e. it was 45.9%.

Primary objectives

The primary objective of the study is to study the theoretical perspectives of public expenditure in India and also studies whether public expenditure forms capital formation or not.

Research Methodology

The methodology is one of the important aspects of a research paper which signifies the strength and extent. In this regard this paper is based on secondary data and from studying the review of literature in India and World the analysis has been made for the trend and structure of Public Expenditure in India.

Perception regarding public expenditure in World

The literature shows that public expenditure plays a very important role in economic development of developing economics not only for the reasons that market failure is comparatively strong in these economics but also for the reason that public expenditure in these economics is wanted for the need of capital formulation as a key to economic development. Economics development is a multi-dimensional process which involves progressive changes in socio-economic structure and is a costly affair and requires as such huge capital formation and is not sufficient for development, reliance on public expenditure

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is greater because of the fact that in these economics public expenditure infact act as a public investment further literature has also shown that though there is link between public expenditure and economic development but that conditioned on the composition of public expenditure i.e. public expenditure in these economics helps to faster developing only if it is incurred on those components which are directly growth promoting. The various studies in that context and the components identified by them are given as follows:

Lewis (1955) saw that the state as a catalyst for development by creating the appropriate institution and incentives to stimulate the growth of a productive capitalist class capital accumulation depends on the institution, values and beliefs of the society.**Lewis (1955;57)** observes that "institutions promote or restrict growth according to the protection they accord to effort according to the protection they accord to effort, according to the opportunities they provide for specialization and according to the freedom maneuver they permit". **Lewis** regarded the safe guarding of property rights as a condition for capital formation. It was therefore necessary to protect private property from public abuse. He argues that without property. "The human race would have no progress what so ever, since there would have been no incentive to improve the environment in which one lived". **Lewis (1955; 376-77)** list nine (9) functions of govt. which are relevant for economic growth and development. They are as follows: maintaining public economic influencing attitudes, shaping economic institution, influencing the use of resources, influencing the distribution of income, controlling the quantity of money, controlling fluctuations, ensuring full employment and influencing the level of investment. **Andros-Gregoriou and Sugata Ghosh:** of Brunel University in their study investigate the impact of govt. expenditure on economic growth, in a heterogeneous panel for 15 developing countries. Using GMM technique, they show that countries with substantial govt. spending have strong growth effect. **Zaidi Sattar:** in his study has revealed that though govt. size has no impact on the economic performance of industrial countries but for low income economies. Though evidences are mixed points towards a positive impact of govt. on economic performance. **Stefano Paternostro, Erwin R. Tiongson and Anand Rajaram** in March 2005 in world banks policy research working paper no. 3555 have shown that composition of public expenditure has become a key instrument by which development agencies seek to promote economic development. In recent years, the development assistance to heavy indebted poor countries (HIPCS) has been made conditional on increased expenditure on categories that are thought to be pro-poor. **Anton Belgrave and Roland Craigewell:** in their study, "the impact of govt. expenditure on economic growth in 'Barbadoos'- a disaggregated approach by using analytical framework of Devrajan et. Al. 1994 try to determine which type of govt. spending capital or current have more effects on economic growth their result shows that there is a positive and statistically significant relationship between economic growth and capital spending i.e. agriculture, transport, health etc. By contrast the relationship between current components of public expenditure and economic growth is negative. **M. Emranul Haque and Densie R. Osborn:** in their study concluded that capital expenditure is positively related and current expenditure is negatively related to economic growth and in a disaggregated analysis of public expenditure education spending are the only outlays that are significantly associated with growth. **Stiglitz 1996:** sees that role of govt. in developing countries as establishing infrastructure in its broadest sense to allow market to fulfil their central role in increasing wealth and living standards. This broad based infrastructure include six roles: promoting education, promoting technology, supporting financial sector, investing in infrastructure, preventing physical degradation, and creating and maintaining a social safety net. [Stiglitz 1996: 13-16]. These roles apply to all types of economies. However, he believes that market failure is more severe in developing countries and as a result, these govt. policies are more urgent in correcting serious market failure. **Diamond (1989) :** carried out on empirical investigation of the contribution of govt. expenditure to the growth performance of a sample of developing countries using the Denison growth accounting approach he concluded that at the aggregate level public spending had not exerted major influence on growth. However, using disaggregated data (expressing each in terms of its share in GDP), he found that social.

Perception regarding public expenditure in India

India is a developing economy. It had remained under colonial rule for around 190 years during the colonial rule, it had been terribly exploited in economic terms. Consequently, when it got independence, it was appeared as a poor and backward economy. Ultimate goal of the country thus, at that, time was economic development and for that path of planned economic development by public sector had been chosen and public expenditure has bene assigned a strategic importance for economic development. Then in 1991, there has been a change in policy from planned to market led economic development however, literature shows that even in a market based economic development, developmental role of public expenditure is no less than that of public planned policy and that specially in case of developing country like pledged for development. In a market based development emphasis are still now or social and economic services as these heads of functional classification have greater development implication. Further, since the focus is more on new educational institutions, health centres, infrastructure then it directed towards need of more capital expenditure. Because revenue expenditure does not result in creation of asset, it is generally incurred for normal running of government departments and various services, interest changes on debt incurred by government etc. further, though the distinguish between plan and new plan components of expenditure does not correspond to that between development and non-development ones. This is because both plan and non plan expenditure contain developmental as well as non developmental items also once a plan scheme is fully operative or a plan project is completed its maintenance and operational expenses are shifted to non-plan budget. Basically, as ever time schemes and projects are completed and shifted to non-plan portion, this component of expenditure trends to increase and its increase is matter of worry only where it is on unproductive items with interest payment.Various studies conduct in India with regard to production of GOI’s expenditure provides results country to what is required?

Shenggen Fan and Anuja Saurkar in their study named public spending in developing countries: Trends, Determination and Impact have compiled govt. expenditure by types across 44 developing countries between 1980-2002. They have analysed trends, determination, and impact of various forms of govt. spending one of their major findings is that total govt. expenditure for 44 countries included in the study increased overtime. Macro economic adjustment did indeed reduce the total govt. spending size. However, they had different consequences for different sectors. For almost all regions the programs have reduced the spending share on agriculture and on infrastructure. As many studies have shown that, these two productive investment have large returns to GDP growth and poverty reduction, the SAP

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adversely affect these development indicators by cutting down spending in these two sectors. **According to Indian Development Report (1999-2000),** In SAP that began in 1991, at the behast of IMF there was a serious attempt to rein in fiscal deficit. As such there was a serious cut in capital expenditure and infact for a substantial part of this period capital expenditure actually registered a negative rate of growth. Whereas growth revenue expenditure continued almost unabated. **Data (1986), Malhotra (1988)** perceived the persistent and sharp rise in non-plan expenditure particularly under interest payments, defence and subsidies, a factor responsibly for deterioration of finances of the central govt. in 1980s. **Singh (1988)** found that a very large part of central govt. expenditure was consumed by the committed expenditure and a very paltry proportion was left for development heads. Further he has also concluded that though large proportion of capital expenditure was incurred under development heads, it remained very low proportion of GNP. Trends and unevenness in public expenditure have been analysed by **Rao, Sen and Ghosh (1995), Shome (1996), Shome, Sen, Gopal Krishan (1996) and Srivastva and Sen (1997)** among others, **Mundell and Rao (1977)** had shown that the sharp growth of current expenditure since 1980s has crowded out public and private investment build up inflationary pressure and stress on BOP and led to emergence of the debt deficit spiral. Studies were also undertaken to look into specific aspects of expenditure on the issue of subsidy burden, **Srivastva and Sen (1997)** estimated that in 1944-95 subsidies constituted 14.4% of GDP at market prices. **Lahiri (2000)** called for the govt., both at centre and state level to undertake measures to reduce untargeted subsidies and also the total outlay on subsides in general. **Srivatva and Amarnath (2001) and Srivastva and Rao (2004)** also brought to the force the critical issues pertaining to subsidies in India. On the issue of expenditure on wages and salaries, **Acharya (2002)** commented that "the fifth pay commission effects constitute the single largest adverse shock to India's public finances in the last decade, while corresponding negative consequences for aggregate saving and investment in the economy. **Rakshit (2000)** analysing the budgetary imbalances in the economy found that they emanated from the consumption of govt. expenditure and modes of its financing and suggested that its orientation towards investment in agriculture and infrastructure facilities rule back of public consumption expenditure and enhanced allocation for social sector especially for primary health care services. **Heller (2004)** on reviewing the fiscal policy framework, noted that it didn't provide for an appropriate expenditure programme that was responsive to the necessary and immediate needs of the economy. Vital spending on primary educational and medical care as well as on infrastructure was also not found to be taking place because of unproductive outlays on subsides and transfer and on excessive compensation and employment in unproductive areas of public sector. **B.S. Ghuman and Akshat Mehta** in international conference on the Asian social protection in comparative perspective at National University of Singapore have shown the New Economic Policy of 1991 had adversely affect allocation of resources in a health sector. Public expenditure on health in India was less than 1% of GDP which had further declined in the post reforms period. Since health "is a critical determinant of economic growth thus they have recommended at least of 3% GDP spending in health by govt. **De, Anuradha, Endow and Tanuka** in their study have shown that there is a acute shortage of resources in education sector in India and economic reforms and associated requirement of fiscal discipline have aggravated the situation. But contrast, however official sources claim that significant progress has been made in financing education. This paper examines whether, and in what ways, this is so. It analyses major trends in public financing of education in India including expenditure of centre, state and others local bodies and the NGO sector, foreign aid is also included. The paper examines the level and composition of public expenditure on education and the mechanism of resource sharing, allocation and utilization, in aggregate as well as separately for centre and state. It find the while expenditure in real terms increased during the 1990's, it has stagnated since then. As a proportion of GDP the share of public expenditure on education on has been less than 4%. **R. Rama Kumar** in his story, "Levels and composition of Public social and Economic expenditure in India, 1950-51 -2005-06 has enquired into changes in the levels and composition of expenditure by the central and state governments in India on the social and economic sectors. Using the 'functional classification of expenditure in the budget document, he has tried to discuss trends in expenditure between 1950-51 -2005-06, with special emphasis on understanding trends in the period of economic reforms in India in the 1990s -2000s. An important concern raised by many development economist during the implementation of economic reform in India was the fiscal adjustment strategy may adversely affect the social sector expenditure. It was argued that the single minded emphasis on reducing budget deficit may result in the relative reduction of expenditure in the soft corner the result of this paper show that overall these fears are largely real. **Pinaki Chakraborty and Yan Zhang (August 2009)** in research paper no. 2009/43, "Economic reforms and infrastructure spending" evidences from China and India-have shown that, in case of India, in post reform period infrastructure spending had adversely affected. They have also concluded that fiscal space has been shrinking due to reform, there is a urgent need for corrective measures to increase the fiscal space for higher infrastructure spending.

Conclusion

The focus of the present study, "Some theoretical aspects of public expenditure in India" is to see that whether or not the allocation of public expenditure is towards certain type of expenditure which are important for achieving higher economic development viz social and economic services, infrastructure promoting capital expenditure and more productive plan expenditure. Since all this type of expenditure are directly supportive to economic development. However, the theoretical analysis of the present study with regard to these services shows that pattern of expenditure of government of India are not fully devoted to that end. Much of the expenditure of revenue, non-plan and unproductive expenditure. Capital expenditure which help to create infrastructure has rather shown decreasing trends and social economic services are increasing very meagrely.

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