International Journal for Research in Engineering Application & Management (IJREAM)
ISSN : 2454-9150 Vol-05, Issue-11, Feb 2020

Public Expenditure & Economic Growth in India- A Review of the Concept

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Abstract: **Public expenditure is an old concept but it entered into academic and policy debate only in early 20th century when J. M. Keynes encouraged the importance of public expenditure in the determination of level of output, income and its distribution. Since then government expenditures has seen an increasing trend. An increasing number of economists and political scientists are becoming concerned about the role of government in the economic affairs of the nation. (Strayer J. Paul, (1949) [8]. Broadly speaking, Public expenditure is defined as spending made by the public authorities of a country to satisfy the collective needs and wants of the society and economy which individual are unable to satisfy efficiently. There are common types of classification of public expenditure as per different economists such as functional classification, Revenue and capital Expenditure, transfer and non-transfer classification, productive and non- productive etc. In India, public expenditure is classified into development and non-development expenditure. Economic growth is the increase in the market value of the goods and services produced in an economy overtime. It can be measured in terms of real GDP. Literatures have shown positive relation between public expenditure and economic growth. Better conceptualization and operationalization of relationship between is helpful to design appropriate economic policies and sustainable development.**

Keywords — Public Finance Public Expenditure, Economic Growth, GDP, Economic Development.

I. Introduction

Public Finance has two main branches, namely, public revenue and public expenditure. We shall discuss about public expenditure. Throughout 19th century, there was a misbelief that public expenditures were wasteful, consequently the size and volume of public expenditure was very small. The government used to follow the laisse faire economic policies & their functions were confined only to defend country from foreign attacks and to maintain law and order within the boundaries of the nation. But at present the expenditure of government has substantially increased after John Maynard Keynes advocated the role of public expenditure in determination of level of employment, income and its distribution.

In the developing countries, the changes in public expenditure not only accelerates economic growth but also ensure economic stability and generate employment opportunities. The public expenditure policy in developing countries also plays a useful role in reducing inequalities in income distribution and reducing poverty. Public expenditure is necessary to meet the various social, economic and regulatory needs of the economy. There is a strong, well recognized link between public expenditure and economic growth. Many public programs are specifically aimed at promoting sustained and equitable economic growth. Public expenditure has played an important role in physical and human capital formation over a period of time. (Gangal & Gupta, 2013) [3].

II. Public Expenditure

Public expenditure consists of expenditure incurred by the public authorities- central government, state governments and local self-governments of a country. Public expenditure can be defined as, “the expenditure incurred by public authorities like central, state and local governments to satisfy the collective social wants of the people”.

The public expenditure can be used to raise the aggregate demand, to direct the allocation of resources in the desired areas, to check the inflation in the economy and to influence the size and composition of national income. The phenomenon of public expenditure growth has been subject for researchers to find out what causes or has effects on it. Wagner (1883) introduces a model that public expenditures are endogenous to economic development, i.e. growth in the economy also causes public sector expenditures to expand. Keynes (1936) and his supporters, however, raise the thought that during recession times the use of fiscal policies boosts economic activities, i.e. expansionary fiscal policies, expanding public expenditures etc., increase community output.(Ra et al., 2008) [6] In the developing countries the role of public expenditure is highly

 DOI : 10.35291/2454-9150.2020.0069

significant. Governments in developing countries spend an average of 26 percent of GDP on goods and services, a figure which has risen by eight percentage points over the last fifteen years (World Bank, 1992). (Devarajan, Swaroop, & Zou, 1996) [1].

III. CAUSES OF GROWTH OF PUBLIC EXPENDITURE

Public expenditure has significantly increased across the globe. In India it looks quite impressive. There are many laws which explain the importance of growth of public expenditure such as Wager's Law of Increasing State Activity and Wiseman-Peacock Hypothesis. In Indian economy, following factors are responsible for the growth in public expenditure:

- **Defence**: Government has to incur large defence expenditure to maintain internal and external security of the country, not only during war time but also during peace time.
- **Expenditure on social security and welfare:** The modern governments being a welfare state have to incur huge expenditure to provide social security to the citizens of the country in the form of health benefits, unemployment allowances, old age pensions, accident security, etc. Healthier workers perform their tasks better—thereby enhancing intellectual capacity and ultimately the quality of the labor force. (Pierre)
- **Anti-Poverty Schemes:** Another important cause of rising public expenditure in India is large expenditure on employment generating schemes and also on anti-poverty schemes. Recently expenditure on these schemes has greatly increased.
- **Increased Public Distribution System:** Public distribution system has been introduced by the government to ensure the supply of essential goods at fair prices to the below people poverty line, those who cannot afford the essential products at the market price.
- **Expenditure on Agricultural Sector:** The government has committed itself to promote the agricultural sector by providing them minimum support price, loans at low rate of interest, providing seeds, fertilizers at cheaper nominal price. These expenditures impose heavy burden on the government.
- **Economic Stability**: With the introduction of Keynes income multiplier the need of public expenditure has increased in order to pump-prime the shortfall in private investment, since maintaining economic stability and achievement of full employment is the chief objective of the government.
- **Economic Growth & Development**: Government in the developing countries invest huge on public utility services and core sectors of the economy which play important role in promoting economic growth and development. Due to these expenditure on development activities, the expenditure of government has risen.
- **Expenditure on Subsidies:** The main cause of fiscal deficit in India is expenditure on subsidies to the various areas of the society such as subsidies to small farmers, exporting units, education, start-ups & so on.
- **Debt Finance**: In India, the government is dependent on debt finance for various development and non-development projects, which is necessary to accelerate the pace of development in developing countries.
- **Development of Infrastructure:** Construction of roads, bridge, power plant and railways are undertaking by the GOI. The Government gives the proper attention to development of social overhead capital which is essential for the development of the country.

IV. CLASSIFICATION OF PUBLIC EXPENDITURE

Classification of public expenditure has different point of view according to different economists such as transfer and non- transfer expenditure, planned and non-planned expenditure, productive and non-productive expenditure, revenue and capital expenditure, etc. In India, the government expenditure is broadly classified into two categories, i.e. development expenditure and non-development expenditure. Within development expenditure, there is a difference between revenue and capital expenditure.

Development Expenditure: It refers to the expenditure of the government on activities which help directly in economic and social development of the country. It increases the production and real income of the country. For instance, expenditure incurred on education, health, rural development, social welfare, housing, etc.

The sub-heads of development expenditure in revenue account are (i) Social and Community services, (ii) Economic services and (iii) Grant-in- aids to states and union territories

The sub-heads of development expenditure in capital account are: (i) loans and advances to states and UT, (ii) loans for social and community development services and (iii) loan for economic services.

Non-development Expenditure: It refers to the government's expenditure on activities which does not help directly in economic and social development of the country. It is incurred on essential routine nature services like administration, defense, judiciary, tax collection, old age pension, etc. It does not add directly to the flow of goods & services of the country.

Non-development expenditure on revenue account is classified into two parts, (i) the general services and (ii) the grant in aid to states and UT and also to other countries.

 DOI : 10.35291/2454-9150.2020.0069

Non-development expenditure on capital account is classified into two parts, (i) loans and advances to states and UT and (ii) advances to foreign countries.

V. IMPORTANCE OF PUBLIC EXPENDITURE

Balanced Growth: Balanced growth is one of the objectives of the government. Government spends & diverts the resources in backward regions to serve the public interest.

Redistribution of Income: Public expenditure improves the economic position of the poor people by providing subsidies, health care facilities, free education, etc. thus public expenditure is a powerful tool to bridge the gap between rich and poor.

Economic Development: The economic infrastructure & social overhead capital plays a crucial role in the economic development of the country. In a developing country like India government make investment in basic and key industries, agriculture, infrastructure, etc. Higher the public expenditure, higher is the level of economic development. Foreign Direct Investment FDI is important for economic growth both in the short and long run. Policies that attract FDI inflows should be encouraged. (Moura, 2011)[4].

Fiscal Policy Tool: Public expenditure can prevent and reduce the impact of cyclical fluctuations. During inflation government cut-back the expenditure and impose taxes at high rates. And during depression more and more expenditures are done by the government to raise the consumption expenditure. The development of endogenous growth models has provided the possibility for a more formal presentation of the interaction between government spending and economic growth. Through its influence on savings, fiscal policy can thus have an influence on the long-run growth rate of an economy.(Educ, 1997)[2].

VI. ECONOMIC GROWTH

The concept of economic growth refers to increase in country's total output or real Gross Domestic Product (GDP) or Gross National Product (GNP) over some time period. The Gross Domestic Product (GDP) is the total value of all final goods and services produced with in a country over a period of time. The output can also express in terms of income. Thus, an increase in GDP refers to increase in production of a country. Economic growth is the part of economic development. Economic development includes economic growth and some progressive structural changes in the economy.

VII. FACTORS AFFECTING ECONOMIC GROWTH

Natural resource: Natural resources like soil, oil, forest, land, water, mineral deposits, rainfall can boost economic growth & have capacity to shift PPC towards right hand side. Improved management of available natural resources can contribute to economic growth.

Human resource: The size and quality of labor has vital importance in determining the production capacity. An educated, skilled and trained labor force is essential to manage complicated machines.

Physical capital or Infrastructure: The level of physical infrastructure determines the capacity of production. Investment in infrastructure such as roads, machinery, factories raise productivity. A higher productivity can increase the level of output in the country.

Technological advance: Technology can increase the productivity at the lower cost with the same level of labor. Technological advance leads to sustained growth. The effect of FDI on economic growth can be recognized via technology upgrading progress, and therefore, the total factor productivity level is added to the model and assumed to be a function of FDI. (Vu Le & Suruga, 2005)[7].

Efficient production: Allocation of resources on the production side as per the changing pattern of the consumption is essential for the growth of the country. Non-utilization & overutilization leads to less efficient production.

Suitable environment: The attitude of the people, government, business leadership, labor leadership towards work, earning and spending can promote growth, if they are seeking it.

VIII. FINDINGS

- There is a positive relationship between public expenditure and economic growth of the economy.
- Economic growth is an important factor for economic development of the nation.
- In some developing countries governments have more unproductive expenditures than productive expenditures.
- There is a bi-directional relationship between public expenditure & economic growth.
- There are some studies which shows relationship from public expenditure to GDP whereas, some shows relationship from GDP to public expenditure.

IX. CONCLUSION

The result of this paper confirms that there in developing country like India radical changes are required to achieve a desired level of economic growth. These changes are possible only with the help of public expenditure. It is the evidence from many studies that higher public expenditure leads to higher economic growth. In order to realize the expected economic growth in our country the performance will largely depend on the efficiency of scaled-up expenditure (Muthui, Kosimbei, Maingi, & Thuku, 2013)

 DOI : 10.35291/2454-9150.2020.0069

[5]. It is hence obvious that there is a positive relationship between public expenditure and economic growth of the nation. An increase in public expenditure leads to economic growth and vice-versa.

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