Chapter II

BUILDING UP A THEORETICAL FRAMEWORK

Introduction

The aim of this study is to determine the factors influencing decision-making process of social sector expenditure. This chapter attempts to develop a theoretical framework for the proposed study. It is divided into the following sections. The first section defines social sector expenditure and places its position in the context of Indian federation. The second section briefs the characteristics of social spending. The third section brings about the rationale for government providing these services. The fourth section describes the existing theories and notions. The final section adapts the theories to the context of social sector expenditure in Indian states and sets the analytical frame for the study.

2.1 Defining Social Sector Expenditure

There is no formal definition of social sector. In popular discussions, it usually refers to the education and health sectors. Several researchers have defined the term differently. In this study, we adopt the budgetary classification of social services, but excluding those items such as natural calamity relief, which do not fit in the normal course. Also the item ‘others’ is excluded as the components included in that are different from the other items under the classification. So social sector expenditure as defined in this study includes public expenditure on education, health, water supply and sanitation, housing, urban development, social welfare, labour welfare, nutrition, and welfare of SCs and STs. However, in this classification, the expenditure on health and education constitutes the major bulk of total expenditure.

India has a federal set up, social sectors coming under the purview of the states. Health is a state subject and education is in the concurrent list, which was a state subject till 1976. With respect to the social sectors, the key decision-makers are the state governments, although the Central government, through various centrally sponsored schemes, contributes to total resource allocation. This sharing of responsibilities is the main institutional factor behind high variation with respect to social spending across states.²

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¹ The item others include public expenditure on information and publicity and other social services.
2.2 Characteristics of Social Sector

Having defined the concept of social sector, this section describes the characteristics of social sector. These services possess certain peculiar properties. Firstly these services are provided both publicly and privately. Secondly the public expenditure on these services is carried out mainly by the governments at the state level, in the Indian context. Thirdly social sector services can be described as both consumption goods as well as capital goods. Apart from rendering immediate consumption benefits it can exert an influence on the beneficiary’s later life as well.Fourthly, it has characteristics of both public and private good. A pure public good is conventionally defined as a good, which has two characteristics: non-rivalry and non-excludability i.e. the marginal cost of an additional person consuming it is zero and the cost of excluding an individual from its benefits is infinite. Following this definition, one can deduce that the social services are not pure public goods as the marginal cost of providing these services to an additional person is substantial, unless there is considerable under utilization of the already existing infrastructure. Since these services are mostly provided by the state, Stiglitz (1974) brands such services as publicly provided private goods and he specifically talks about education being so. Social sector services are excludable, and therefore one can easily charge for it. They are mostly rivalrous, as one person availing a certain service reduces the availability of that respective service to another, again exception arising if underused facilities are prevalent. These characteristics are of a private good. But one of the features that make these goods different from pure private goods is the existence of externalities in consumption. This, in turn, makes social return or social benefits divergent from private benefits. Externalities imply that benefits arising from these services do not exclusively accrue to those who consume them. This provides an important rationale for the state’s role in providing such goods. The various components of each item under social sector vary in their extent of externalities or the degrees of publicness. For instance in education, school education, particularly, the elementary education, has large externalities while higher education has less of them.

A feature that distinguishes social sector expenditure from the other items of public expenditure is that the expenditure on social services requires higher recurrent outlays, and this may be in excess of the potential increase in public sector revenues. These services are such that, the character and timing of their output flows may not lead to sufficient immediate
growth in tax revenues to finance their recurrent costs (Heller, 1978). This feature may be contributing to the revenue deficit.

2.3 Rationale for Government Providing these Services

As we have already indicated above, the arguments for government provision of social services stem from the characteristics of the same. It is often the market failures that call forth government intervention. The market fails to allocate resources efficiently in the following circumstances.

Firstly the externalities that characterise the social sector services make the benefits from this spill over to people other than those who consume the services. These externalities that arise from a literate, healthy manpower are hard to quantify. These services tend to be underprovided by private producers since individuals will not be willing to pay as much as the providers are willing to accept. This is due to the fact that the consumers of these services consider only their private return, which is only a portion of the total returns and therefore the private investment may be less than what is optimum.

Secondly there is the systematic underestimation of the value of these services. The ignorance of the existence of such services and the benefits that generate from these make the investment in these less than what is required if left to private hands. There is an informational problem associated with it. There are instances where demand is extremely inelastic or in other words price doesn’t influence the demand at all. However lower the prices are, there may be people who are unwilling to avail the services unless some extra incentive is given to them. Associated with this is the problem due to deviation from the principle of consumer sovereignty. The social sector services are such that the final ‘consumer’ is often not the agent who makes the decision. For example, in education, the relevant decision making unit is usually the household and it is the parents who take decisions for the child. Similarly in health care, the user of health care services has very limited role in the decision regarding the quantum of a service. It is usually the physician who decides what kinds of tests have to be performed. This coupled with informational problem can create large gaps between the availability of such services and the need (however defined) for them.

Thirdly, failures in the associate markets, particularly credit market also call forth government intervention. The private purchases of these services are beyond the means of poor people. It
involves high risks for both borrower and lender as the returns from these services are not monetary and even if monetary benefits are there, they are uncertain.

Lastly, it is on distributional grounds that public provision of social services is undertaken. The opportunity for education, health and better nutritional status should be equal for all the people, despite their ability to pay. There exists a view that there are goods and services, such as health care, whose availability to different individuals should not just depend on their incomes, but should be based on attributes such as age. This was referred to as specific egalitarianism (Tobin, 1970 cited in Stiglitz, 1988)

Having explained the economic rationale for public provision of social services, one may like to examine to what extent the pattern of public expenditure actually observed can be explained in terms of those arguments. This assumes particular importance in the Indian context since the bulk of social service expenditure is on the revenue account, and the rising revenue deficit in all the states is considered to be serious.

2.4 Existing Theories and Notions

Market failures and the redistributive objectives are the prime arguments for government intervention, as was elaborated in the previous section. But there is often significant difference between the stated objective of the programme and the design of the programme (Stiglitz, 1988). This phenomenon has led to two approaches to view the problem i.e. the normative and positive approaches. The market failure approach is a normative view of looking at the issue. Instead, the positive approach looks at the actual allocations and tries to explain in terms of various factors including the interests of the agents involved in the decision making process. Taking a historical view of the development of the theories related to this field, one could notice a gradual shift in the focus, from a normative approach to a positive approach.

The early economic approach was dominated by the marginalist theory and the marginal theory was adapted to fiscal control by Hawtrey and later expanded by Pigou (cited in Premchand, 1983). The essence of these propositions was that the last penny spent on the different avenues of expenditure must yield the same return. But these were characterized by difficulty in measurement and this is particularly so in the case of social services, which is the focus of this study, whose benefits are intangible. In the 1950s, the theories of the public goods by Samuelson (1954) were put forward, and this again revolved around maximizing
social welfare. This was characterized by aggregation of individual benefits. The government was viewed simply as an institution for balancing individual demand for public policies appeasing the voters. These theoretical notions considered individuals in the prime position and the decision-makers were mechanical, in implementing their demands, that mode of allocation chosen was to maximize social welfare which was the aggregation of individual welfare. However in the rent seeking literature, another side of the government is exposed wherein it seeks wealth and leisure and these can influence the outcomes of the public sector (Mueller, 1989). It was Musgrave (1959) who finally shifted the focus to the political processes and this recognition paved way to the several public choice theories taking into account the various agents involved. Also the maximization of welfare, by aggregating the individual preferences, was relegated to the background by Arrow (cited in Burkhead et al, 1971) when he suggested that there is no logically consistent mechanism for the aggregation of individual preference to provide the basis for a collective choice. Contemporary to these developments, the positive approaches like Wagner's law and Peacock's displacement hypothesis gained greater momentum in empirical analysis. Now we examine each theory in detail and try to place them in an integrated framework for analysing public expenditure on the social sector.

Before going into the detailed review of the existing theories, one may also look at another strand of literature that suggests that the expenditure decision-making process is just random or unintended outcome of other activities. This is the idea behind the garbage can model (March et al, 1976). But this strand has been criticised, as it is too unrealistic to expect that despite the amount of planning, the outcomes are just random. There is also a view that public expenditure decisions happen in an incremental manner (Davis et al, 1966). The decisions regarding public expenditure are taken in a very hasty manner and hence some ad-hoc addition to the last year’s expenditure seems to be the most convenient thing to do.

Various theoretical approaches and various models that are generated following these approaches have their respective contributions to our understanding of public expenditure in general and social sector expenditure in particular. A review of these approaches helps us realise the need for a somewhat integrated model, which would perhaps be more illuminating in the Indian context. There are various agents associated with the decision making process and each agent is guided by different objectives. These objectives may conflict with each other and the outcome would depend on how these conflicts are resolved in the process. On
the one hand, the government has the objective to correct the market failures and make the services available to all irrespective of their ability to pay. But it is also faced with the rent seeking motives of the various agents, i.e. the politicians who may or may not be part of the decision making process, the bureaucrats, the interest groups and so on. These objectives and interests of various agents may be conditioned by a variety of factors, including the spending capacity of the state.

An attempt towards an integrated model was made by Tarschys (1975). He identifies three perspectives as well as three levels at which these perspectives play a role. The former includes the producers, the consumers and the financial side, which can be blended to either of these two. The three levels that play a role are the socio economic characteristics, the ideological cognitive level and the institutional level, which binds the two. According to the model, the socio-economic characteristics form the background to which the actual demands and aspirations and outlook are framed. The actual and desired demands are interlinked by the institutional mechanism.

Table 2.1 Different Causes of the Growth of Public Expenditure as Envisaged in the Tarchys’ Model

<table>
<thead>
<tr>
<th>Socio economic level</th>
<th>Consumer Perspective</th>
<th>Financial Perspective</th>
<th>Producer Perspective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Socio economic level</td>
<td>Greater demand for public services as a result of increased geographical mobility, industrial reorganization, population changes and so forth.</td>
<td>A relatively large public sector requires larger taxes, which is possible only in a rich society.</td>
<td>Horizontal differentiation, decreased working hours and increased inefficiency require more public employees even at a given level of communal service.</td>
</tr>
<tr>
<td>Ideological cognitive level</td>
<td>Greater demand for public services at higher income levels.</td>
<td>The larger tax burden is tolerated by the citizens in a relatively rich society. A high tax ratio is also dependent on the legitimacy of the govt.</td>
<td>Bureau maximization by administrators and professionalisation lead to a larger public sector on account of status and ideologies.</td>
</tr>
<tr>
<td>Political institutional level</td>
<td>Greater demand for public services on account of strong interest groups, lobbying, and collusion between interest organizations on one hand and parliament and administration on the other.</td>
<td>Progressive taxes and more taxes also allow for a larger tax yield. Vertical differentiation of public functions increases expenditures.</td>
<td>More parliamentarians and voters are also public employees, which decreases the possibility to restrain internal demands from the public apparatus. Coalitions between various groups in society make matters worse.</td>
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The importance of Tarschys’ model is that the different arguments for the growth of the public sector are presented and it provides a comprehensive view of the same. The model describes twenty-five different reasons for the growth of the government (Lybeck, 1986). However such categorisation as that of the consumer and the producer as two distinct identities is not
followed in this study. The cases of the consumers and the government are examined in the light of the various theories. However these two are not clear-cut distinct identities. The consumer takes part in decision-making process through the political processes. The political set up of a state is shaped by the nature of the organisation of the society.

First let us examine the case of the consumers. The role of the voter and his role in public expenditure decision are a complex one. The median voter model, according to which public expenditure levels are determined or are in correspondence to the preferences of the median voter, is characterized by difficulties in empirical testing (Atkinson et al., 1980). In the real situation, there exists multiple interests, different levels of inequality and different interest groups. Regarding the role of inequality there are two opposite views. According to one view, higher inequality implies many people below the average income level, which in turn implies higher tax rate and thereby high level of public expenditure. Under majority voting rule, the policies reflect the preferences of the median voter and the low-income median voter prefers the tax rate which maximizes transfers (Meltzer et al., 1981). The second view is supported by the explanation that higher the inequality, more diverse will be the interests or less bargaining power the various interest groups will have and less will be the public expenditure (Peltzman, 1980). Implicit in these two arguments, is the idea that the nature of the demand generated from the population and its credibility is what is important. The basic rationale for government intervention is to compensate the inegalitarian consequences of income inequality existing in the society. The actual provisioning of the services, however corresponds, perhaps, to the needs of the people, or to other influences. This leads us to the nature of organization of the society and the extent of credibility the demands raised can exert. From the preceding discussion, what follows is that the nature of the public has an impact on the decisions made. But the decision need not reflect the opinion of the general public, but certain specific groups. The demographic features such as dependency ratio that reflect the entire population may not be a factor. This can play a significant influence only if the government decisions are need oriented. This takes us to the role of the interest groups.

According to the interest group theories, public expenditure is so designed to appease certain interest groups, and the state's role is more or less a mechanism acceding to their demands. The Marxian theory pinpoints that the state acts for the dominant class. For the neo classical economists, the state's activities are directed at the rent seeking behaviour of various interest groups and lobbies. There may be more than one interest group, and thereby facilitating the
formation of coalitions. The chief proponent of this idea, in the Indian context, is Bardhan (1984) and he identifies three dominant classes that consist of rich farmers, big industrialists and professionals and bureaucrats. These groups can exert influence on the expenditure pattern. Even in the democratic set up, where a free voting system prevails, interest groups assume a powerful place, as they are capable of providing selective information to the government and extending financial support to the political parties. But the prevalence of a majority of people who do not belong to the interest group limits the government’s behaviour in favour of the interest group. Connor (1973) brings in the need of the government to strike a balance in this aspect, to pacify the poor and unemployed, sanctioning expenditure in their favour. This is the expenditure needed to maintain the social harmony or buy off the poor. Mueller et al (1986) following their empirical examination posited a positive relation between public expenditure and number of interest groups. The nature and the potential success of interest groups have been analysed in terms of characteristics such as size of the group. Olson (1965) puts forth the idea that small groups are more likely to succeed in collective action, as it is the size of the benefits an individual receives relative to the cost that is important, not the number of members. This proposition has been refuted, saying that there is no logical connection between the size of the group and its success (Hardin, 1982). The point that can be drawn out from here in strengthening our framework is that interest groups can play a role, but the success in its interest being implemented depends on its characteristics. Therefore it is not necessary that every interest group is successful in its collective action.

It can now be stated that as far as the provision of public services is concerned, two kinds of influences are likely to be generated from the consumers. One would correspond to the basic objectives which guide government provision of such services, and the other corresponds to influences such as specific interest groups or vested interests. The demographic features that reflect the entire population can affect the expenditure decisions (Tait et al, 1988), or alternatively the benefits of such expenditure may be accruing to a specific section of the population whose demands are finally heard by the decision makers.

As was mentioned before, the consumer is not a distinct identity from the government. These demands generated from the population have to find their way in the electoral and organisational processes. And this takes us to the realm of political theories and theories of the bureaucracy.
The political theories or electoral theories deal with the interaction between the voters and the politicians in power. According to Hotelling-Downs model (Downs, 1957), the politicians aim at winning elections and will act accordingly. Nordhaus (1975) discusses periodic revision of expenditure policies in correspondence with electoral cycles. There will be populist measures to win the backing of the people. According to Frey (1978) the ideology of the decision-maker plays a role. In the Indian context, ideological leanings of parties in power do not seem to be strong enough to make a significant difference in the level of expenditure on social services, according to Rao (1981). It is based on an analysis of a select group of states, viz. Kerala Karnataka, Orissa and West Bengal. It is shown in the study that the level of social spending is high during times of unstable governments.

The influence of political regimes on spending programmes has come to invite two arguments related to its role. One school of thought attaches significant role to these aspects (Kohli, 1987 cited in Hariss, 1999) while another group denies any role for the same (Vyas et al, 1995). These arguments are related to mainly poverty alleviation programmes and not social spending.

Besides politicians, the other group of people who are considered to be important in their influence on public expenditure decision processes are bureaucrats. They, unlike the politicians, are not elected. The most well-known theory of the bureaucrats is due to Niskanen (1971). In his model, the bureau serves as the provider and the elected representatives as the sponsor. There is an associated measurement problem inherent in many of the public goods and services and so there is a monitoring problem for the funding agency. If the bureaus serve as monopolies, the true cost schedule will not be revealed. The bureaus are free from competitive pressure. These attributes bring in an element of inefficiency into the system. This is further enhanced by the fact that public bureaucrat’s scheme of compensation is inversely related to improved efficiency. The model by Niskanen assumes that bureaus are monopolist suppliers and it alone knows its cost schedule (Mueller, 1989). Whenever or wherever the sponsor can partially monitor and penalize the bureau, provided there is information for that, the bureau is forced to declare a price closer to its true marginal cost. If the bureaucrats are risk averse, and the probability of getting caught is strengthened, the bureau may work with efficiency. The risk averse officials concentrate on providing measurable output, thereby facilitating monitoring (Lindsay, 1976). Another argument for increasing public expenditure is that public sector activities are characterised by labour
intensive methods and hence offer few opportunities for introduction of technological change (Baumol, 1967). Peacock (1971) added to this dimension as he brought in the role of bureaucrats as characterised by the lack of incentive to introduce innovations.

The discussion till now has been concerned about the role of the voters, politicians and bureaucrats. The generation of demands on the side of the voters, its transmission to decision making mechanism, its differential impact in getting implemented, the political motives of the decision makers, and the nature of susceptibility to be inefficient on the part of the bureaucrats were discussed. However, as we mentioned earlier, the roles of these agents are conditioned by the spending capacity.

The seminal theoretical backing that relates public expenditure to national income was formulated by H. C. Adams (1898 cited in Peacock et al 1961) who suggested that government’s expenditure must grow in proportion to a community’s output per head. In the same period, continental writers of the younger historical school, led by Wagner (1890) systematised the whole proposition, and he argued that a long run relation exists between public spending and national income. His analysis was based on historical evidence and he envisaged the pressure of social progress and the resulting changes in the private and public economy as the explanation, justification and the cause for the same. As he puts it, financial stringency may hamper the expansion of state activities, causing their extent to be conditioned by revenue rather than the other way round. But in the long run the desire for development of progressive people will always overcome these financial difficulties.

A serious criticism levelled against Wagner by Peacock et al (1961) was that his proof of his law depended on the validity of the organic theory of the state in which the state is assigned a certain mode of behaviour. Peacock’s argument that the perception of the role of the state is a key determinant of the size of the expenditure is well accepted by contemporary writers as well (Drazen, 2000). Views of the proper role of the state have changed considerably over the last two centuries. Following the extremely regulative government in the 18th century, 19th century economists beginning with Adam Smith argued for a minimal role of the state. The depression of the 1930s and the development of the theory of Keynes in the contemporary period emphasized a greater role for the government. Advances in the theory of public finance starting with Samuelson’s theory of public expenditure provided the basis for larger allocative role of the state. By the late 1960s and certainly by 1980s there has been a reversal
in the enthusiasm for an active government. However empirical investigation in this direction has pointed out that the strong calls for smaller government do not appear to be accompanied by equally strong actions in cutting the size of the govt (Tanzi et al, 1995). This point is further emphasised by Drazen (2000) when he says that changing perceptions of the role of the state in the twentieth century played a large part in the growth of the size of the government, but apparently less so in arresting and reversing that growth.

Moreover the three types of activities that Wagner used to explain his law were related to maintenance and enforcement of law and order internally and externally, provision of necessary social preconditions for markets to function and provision of social services. These functions in fact pertain to the state irrespective of the perception of its role. Even the schools of thought that advocated for minimal government role accommodated these functions as that of the government.

However there have been numerous empirical studies related to Wagner’s law. Many have validated the law and almost an equal number invalidated. The empirical examination has also been accompanied by a gradual improvement in the methodology employed. The earlier studies were based on simple Granger causality tests assuming that the data was stationary (Sahni et al, 1984; Bhat et al, 1991). Later the studies were undertaken in the framework of cointegration and error correction mechanism, accommodating for the non-stationary nature of the series (Mohsin et al 1995; Sahoo, 2000). A study related to the Indian states rejected any relation between State Domestic Product and public expenditure only in two states, Bihar and West Bengal. On examining the direction of causation, Wagner’s law was proved in eight states. The lack of empirical support of the law in some states suggests that the law is not a universal one (Mohsin et al, 1995). Apart from the works that examine the relationship between national income and total public expenditure, there have been studies that relate income and specific components of social expenditure, for instance, health expenditure or education expenditure (McCoskey et al, 1998; Roy et al, 1998; Gerdtham et al, 2000).

Musgrave (1969) tries to explain the invalidation of Wagner’s hypothesis by bringing in some activity specific and region specific aspects. He contends that the response to economic development of different components of public expenditure varies. He also brings in the role of the stages of economic development across which the pattern changes and there is the argument that Wagner’s law is applicable only to the economies at the earlier stage of
development. The earlier empirical studies (Musgrave, 1969; Pryor, 1978) confirmed the phase of economic development as one of the determinants of the pattern of public expenditure. The study by Pryor (1978) which included 14 countries from 1950 to 1962 concluded that the connection between per capita income and the share of public expenditure is primarily manifest as an economy passes through transition from agricultural-rural to industrial-urban and per capita income rises from around $200 to $600. Once this transition is attained, he holds, the relation appears more random. Musgrave's cross sectional study concludes that for countries whose per capita income is less than $600, social expenditure correlates positively and more strongly than total expenditure. For countries with incomes more than $600 per capita the relation between social expenditure and income is negative, as is the case of total public expenditure. Here it seems to suggest that there is a threshold level of income of the state beyond which expenditures do not rise in proportion. Musgrave's time series analysis shows that only certain components of public expenditure exhibit a relationship with income like social sector outlays.

Musgrave (1969) presents a transitional role of the government as the economy develops. He divides total expenditure into public capital formation, public consumption and transfer payments. In the early stages of development there is high ratio of public investment to income of the state to provide infrastructure. Also in the early stages of growth there is the absence of developed markets for private capital, and also limited taxable capacity and this necessitates public investment in nonexternality yielding capital formation. As development occurs both these situations change but new avenues open as to complement private investment. Even at higher levels of development, there is the need for high social investment, to meet the requirement arising from technological advancement. This points out that at all stages of transitions, the government plays a significant role in social sectors.

Till now the discussion has been concerned with relating public expenditure to income. There are certain intermediary factors that play a role in between these two. The relation between income and revenue is facilitated through tax performance of the states. Tax performance is the extent of utilisation of the revenue raising potential. It measures the proportion of the income generated in the economy that is taxed. There are three factors that influence tax performance (Chelliah et al, 2002). They are the growth in the potential tax base, the details of the tax law and the efficiency of the tax administration system. The growth in the potential tax base can be different from the growth of the income of the state. Each tax targets a part of
total income and the differentials in the growth rate of these components can influence the tax performance. The details of the tax law come in the form of exemptions and deductions. Higher the tax performance, closer is the actual tax collection to the potential tax collection and stronger is the relation between income and revenue. More the revenue, more is the spending capacity of the state. The role of the tax system, its income elasticity and progressive nature has been identified as a factor influencing expenditure (Hindrichs, 1966; Musgrave, 1969).

Another factor that can have an influence is the financial constraint of the government. Fiscal deficit denotes a situation of financial constraint, and it conceptually means the excess of expenditure over revenue excluding borrowings. The amount of fiscal deficit of a certain year can influence the spending decisions of the next year. Previous year’s deficit was identified as a variable for the expenditure pattern (Morss et al, 1967). Under situations of financial crunch, the social sector projects are likely to be postponed more than other heads of expenditure (Basu, 1995). The concept precisely refers to the fact that it is less costly in financial terms to postpone setting up of a new school or hospital than postponing completion of a fertiliser plant or power plant. This phenomenon affects capital expenditure more than revenue expenditure.

Another factor that governs the spending capacity of the state is the amount of grants from various sources. The grants may be allocated on a matching grant basis or based on allocational formulas. Irrespective of income and tax performance, a state can spend more in proportion because of the transfers. The role of state and federal aid in determining public expenditure has been identified by several studies (Sacks et al, 1964; Osman, 1968).

The three factors that are cited above do not exert their influence in isolation; a variety of linkages are possible. The details of them are not our focus here. Deficits arise due to rise in expenditure or due to reduction in revenue mobilization or a combination of both. Revenue mobilization is related to the tax performance of the state which in turn is a function of efficiency of tax administration. If the tax performance is poor, or has deteriorated over time, deficits will arise. On the question of incentives for a state to increase its tax performance, there are different factors operating. Higher the deficit in a year, greater will be the tax effort on the part of the state in the succeeding year (Morss et al, 1967). Of course tax effort depends on many other factors, but there may be a kind of need felt among the concerned authorities to
correct the lack of efficiency involved in the tax administration system. However this is also influenced by the system of transfers from the Centre, the criteria adopted for such transfer. What all this suggests is that the factors do not play their role in isolation, which in turn may imply that the net effect on spending can be nullifying, reinforcing or without any impact.

The discussion so far pertained to the various factors influencing the different agents associated with public expenditure decision-making. The initial view of citizen over the state was replaced as the various rent-seeking motives of the different agents were identified. It is meaningless to search for one single motivation behind public expenditure decision-making. It is characterised by collective motives. On the one hand, the objective is to correct the market failures associated with these services. There are, however, politicians, bureaucrats, interest groups who play a role to satisfy their own interests. Therefore, even if two governments have identical objectives, circumstances and pattern of preferences on the part of the consumers, there is no necessity that the same pattern of expenditure will be the result.

2.5 Building up an Analytical Frame for the Proposed Theme

As was observed, there is no well-formulated integrated theoretical framework for linking up social sector expenditure and its determinants. Here in this study, a positive approach is adopted i.e. to gain insights into the decision-making, actual allocation patterns along with possible contributing factors are examined. From the existing literature, the factors that can influence social spending in the context of the Indian states are identified. A comprehensive view is depicted in the following schematic representation.
Fig: 2.1 Factors Influencing Social Sector Expenditure in a State

Transfers from Centre

Tax Share

Grants

Income

Own Revenue

Spending

Social Services

Developmental Expenditure

Economic Services

Non-developmental Expenditure

Others

Tax Performance

Last Year's Fiscal Deficit

Demographic Features, Interest Groups, Political Regimes and Bureaucracy

Influences

Influences

Influences
The extent of disparity in social sector expenditure across the Indian states is analysed. The factors contributing to these differentials are examined. The factors that are examined are the differences in state domestic product, tax effort, demographic composition, the political regimes and the interest groups. Within a state, the pattern of social spending may change and the factors that may contribute to this change, if any, may be the income level, tax performance, deficit and the discretionary transfer. By examining the influence of fiscal deficit, the applicability of the postponability criterion is examined. The extent of applicability of the incrementalist view in the expenditure allocation is also examined by examining the allocation patterns.

As was noted, the nature of demands generated differs in the different states depending upon composition of the population, their extent of political participation and the nature of inequality. The demographic features may or may not play a role depending on the nature of realisation of the objectives of social sector spending. The demographic features that are included for the analysis are dependency ratio, percentage of scheduled castes and scheduled tribes in the total population and population density. Dependency ratio is defined as the ratio between the number of people in the age 0-14 and 60+ to the number of people in the age group 15-59. Population density is the population of an area per square kilometre. Ideally, higher the dependency ratio, higher should be the social sector expenditure, according to the principle of specific egalitarianism wherein the expenditure decisions should be based on attributes such as age. The scheduled caste and tribe population is the generally the underprivileged section and the presence of these should prompt a demand responsive system to offer more. But these relations are based on the underlying assumption that the expenditure decisions are corresponding to the rationale for government intervention. Similarly population density is also expected to have a positive relation with the same. A cross sectional analysis of the states is taken up to identify the influence of these factors. Here the interstate differences are analysed. The hypothesis in this regard is that if these factors are significant and have the expected sign, then the regional distribution of social sector expenditure or the existing system of distribution is corresponding to the rationale for government intervention. The role of the interest groups is analysed by examining specific patterns in intra sectoral allocation. If at any specific case, the intra sectoral allocation fails to fit in the general pattern, the interest groups' role is hinted at.

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3 These definitions are taken from the Census of India Reports.
Besides composition of the population, the nature of political participation and the nature of political evolution also play a role. By political evolution what is implied is the nature of the parties that have dominated power in the past decades and its tenure or extent of stability of the ruling party. The role of the political regimes on social spending is examined after adopting the classifications of the Indian states based on their political regimes put forward by Hariss (1999).

The study also examines the pattern of social spending within a state across a time span. The factors that influence the spending capacity of a state are the income, tax performance, the deficit and the transfers from the centre. Adapting the Wagner's law to this situation, there is justification in expecting a long run relation between income and social spending. Each argument will be examined one by one to see how the relation fits in here. According to the Wagner's law, the increase in the social sector expenditure is one of the activities that are bound to happen in the process that he envisaged. The second line of thought regarding the perception of the role of the state also goes in favour of the long run association. The role of the state in the provision of the social services has been well recognized under all stages of transformation of the perception regarding the role of the state. In the present period where there are active discussions about the reduction in the size of the government, a consensus is emerging regarding the new role of the state with great focus on areas of human development (Shome et al, 1996). Regarding the deficits, Wagner foresaw them but casted it as a short-term phenomenon and was sure about the fact that income would eventually emerge as the basis, not revenue. But the persisting revenue deficit that has driven many a state into a fiscal jeopardy may not have been in his mind. Considering the stages of economic development, the Indian states vary a great deal. Following Musgrave, we can state that at all stages of development, the role of the government in social spending is well identified but the nature of relationship seems to be varying. In the cross sectional analysis, there seemed to be a threshold level of development operating, beyond which, the relationship varied. The notion that expenditure decisions are guided by incrementalist pattern is examined by the allocation of the plan components of education and health resources.

As cited above the other factors that influence the spending capacity of the state are tax performance, the deficit level and the transfers from the Centre. Tax performance is the ratio between own tax revenue to the state domestic product. Fiscal deficits of the respective states are examined for impact in expenditure patterns. In the context of Indian states, apart from the
income of the state, the transfers from the Centre also play a role in determining the spending capacity of the state. There are multiple channels of transfers i.e. following finance commission recommendations, through planning commission and the various central ministries. The transfers are either tax share or grants. The grants have a statutory component as well as a discretionary component. The statutory components are so designed that they are equity promoting in nature. But the discretionary component is not guided by any criterion. The centrally sponsored schemes constitute a high proportion of the total discretionary transfer. They are shared cost programmes with matching ratios that are uniform across states, but vary with the projects. These transfers have been criticised much owing to their discretionary nature and conditionality attached to them (Rao, 1999). The quantum of transfers can certainly influence the spending pattern of a state. Also high level of expenditure due to interest payments, for instance, may hinder the amount that can be spent for other items of expenditure.

These factors do not play their role in isolation. Instead they tend to reinforce or nullify their impact on expenditure. The finance commissions' policy of filling the revenue gap, without considering the tax effort, till recently, has been working as a disincentive on the part of the states to enhance their tax effort. This situation will lead to a situation where manipulation of a higher deficit may be a device to secure higher devolution (Rao, 1981). But in the last two finance commissions, tax effort was included as a criterion in the devolution of the divisible pool. And also for the grants in aid, a fifteen percent of the total funds were set apart linking it to the performance. The inclusion of tax performance as a criterion for transfer imparts an element of incentive to improve the tax performance.

Conclusion

It is based on this framework that the dissertation proceeds. The next two chapters deal with these issues empirically. The next chapter empirically examines the allocation patterns of social sector spending in the states. The subsequent chapter takes up the cases of four selected states and examines the intersectoral and intrasectoral allocation of education and health resources that constitute the bulk of social sector expenditure.