CHAPTER - 1

INTRODUCTION
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Economic development has been engineered by paternalistic Governments in most of the developing countries. There seems to be several reasons why the Governments of developing countries are playing a more active role in generating economic development than those of western countries.

The most important is that to achieve industrialization, resources have to be created and put into use. But markets for these resources (for example, the foreign exchange market and the financial market) are either very inadequate or non-existent. The Government, therefore, has to create an institutional frame work for developing the market for these resources and guide the people to adapt themselves to it.

Second, inertia in the social atmosphere has to be defeated and this calls for government action. Employment has to be created right way and entrepreneurship has to be stimulated. The rudimentary market system existing in developing countries may be too inadequate and too slow to generate the process of development rapid enough to fulfill people's expectations.

Third, the developing countries are accustomed to being ruled by paternalistic Governments; the people look for Government assistance and support, even under normal circumstances. The Government is called upon to solve all problems, including those that should be handled by private individuals and non-Governmental institutions. The Governments of developing countries are, thus, likely to intervene in the private sector of the economy.¹

The basic condition for economic development is the creation of infrastructural facilities and social overhead capital, which requires huge investment. The private market economy is unable to create the needed economic infrastructure and social overhead capital in developing countries like India. The creation of economic infrastructure such as Electricity, Irrigation, Transportation and Communication and
Social overhead capital such as Education, Medical and Public health and social security measures has become the main responsibility of the Governments in developing countries. To provide all these facilities Governments have to spend more amount of money through public expenditure policies.

**Importance and Role of Public Expenditure**

Public Expenditure is one of the most effective measures whereby different economic and social objectives of the country are sought to be realised. In fact, Public Expenditure has a multiplicity of aspects. The aspects of Public expenditure mainly consists of the acceleration of the rate of economic growth, equitable distribution of income, improving the living standards, stabilisation of economic activity, balanced regional development in addition to the orthodox classical objectives of defence, maintenance of law and order and the like.

Public expenditure on economic and social overheads such as agriculture and allied activities, irrigation, electricity, industry and mines, roads and bridges, education, medical and public health assists the productive process in the economy and thus, helps in raising the aggregate output. Expenditure on Defence, Police, Justice and Jails ensures relatively peaceful living of the citizens and helps to carry on their productive avocations undisturbed in addition to the protection of territory against foreign aggression. Likewise, a heavy dose of investment during a period of depression and curtailment of expenditure during a period of boom helps in maintaining economic stability.

Public expenditure tries to bring regional balance in the economy as well. In every State, there are some underdeveloped regions. Government expenditure can be effective in bringing prosperity to such depressed areas through the allocation of greater proportion of Public expenditure on different Socio-economic upliftment programmes and thereby may ensure balanced regional development.
Public expenditure programmes have large effects on the distribution of income. It redistributes income both vertically and horizontally. Expenditure on the transfer payments (i.e. expenditure incurred on various Social Security Schemes, such as Old age pensions, Veterans benefits, Unemployment compensation/relief, Sickness and invalidity benefits, Family allowances, Scholarships, Subsidies on food and housing etc.) redistributes income vertically. All these expenditures add to the income of the recipients directly. Government spending on infrastructure, drinking water supply, and other social and economic services affect the income distribution horizontally. Such Government expenditure provides benefits to the Society at large. In particular, expenditure on education and health services improves the educational and health standards of the people and makes them more active agents of production. Public expenditure can, thus, be used for augmenting production, reducing income inequalities, improving living standards, ensuring balanced regional development, maintaining law and order and for stabilisation purposes.

One of the striking changes which has taken place during the second half of the twentieth century was that most developing countries of the world have been inspired by the idea of a “Welfare State.” Though they are willing for economic growth, they face tremendous demand for the welfare of their people. In result, the egalitarian objective is explicitly emphasised in the development programmes of developing countries. The egalitarian objective seeks for equalisation of opportunities to all because all, being equal, have claims in this respect. In developing countries, therefore, Public expenditures are assigned the role of not only accelerating the growth of the economy through appropriate resource allocation but also ensuring better distribution of income and the like. While acceleration of the rate of economic growth undoubtedly remains the permanent objective, the social and distributional aspects of Public expenditure have also emerged as major policy objectives.
The problem in developing countries is not one of deficiency in consumption demand, but of low levels of saving and investment. Increase in the levels of expenditure, especially, the investment expenditure is imperative to enhance the rate of capital formation, because Capital formation is a fundamental requirement for economic development. Private savings are very low in the early stages of development and hence the Governments usually must play a major role in accumulating capital. Investment in infrastructure, particularly during the early stages of development, is of crucial importance as it sets the framework for subsequent investments by both the private and public sectors. Furthermore, even in the later stages of development, the private sector may not be able to generate the massive funds required to establish certain industries, despite their long-run profitability. The Government may also create certain “linkages” that will permit the private sector to flourish in the future. Lastly, the Government must often assist in the creation of human capital through educating and training the labour force.

REVIEW OF LITERATURE

The literature on Public expenditure has grown rapidly in recent years. But a few decades back it was considered that the area of Public expenditure was a neglected and unexplored subject for research by Economists and Social Scientists. This concern has been shared by those writers who believe that “in contrast to many important empirical studies of taxation in developing countries, there are relatively few similar studies in the field of Public expenditure in developing countries.”2 In fact, such views were expressed by many western writers including those of Samuelson and Musgrave. Even in India similar opinions were voiced. “The area of Public expenditure has not, however, obtained as much emphasis as it deserves in Indian finance research. The positive aspects of Indian Public expenditure analysis remain largely an unexplored field.”3 However, in the past few decades, particularly after 1950s gradually many have evinced interest in the study of Public expenditure and consequently the literature has increased. The available literature on the growth of Public expenditure may be broadly
categorised into (1) International Studies, (2) National Studies and (3) Regional Studies.

**International Studies on Public expenditure**

The following are the important international studies on Growth of Public expenditure.

**Wagner’s hypothesis of Public Expenditure**

Adolph Wagner (1835-1917), a German economist presented a systematic approach explaining the theory of Public expenditure and factors responsible for its growth. His approach was correlative to the growth of community output and public expenditure as was observed in a number of Western European countries.

The main thrust of Wagner’s hypothesis was on the functional relationship between the growth of economy and its relative growth of public sector activity. According to him, the Government expenditure must increase at an even faster rate than output.

**Peacock and Wiseman’s Study**

The empirical study of Peacock and Wiseman (1967) emphasizes the time-pattern trends of Public expenditure in U.K. from 1890-1955. Their analysis is based on three separate but related concepts, viz., displacement, inspection and concentration effects.

According to them, during the period of study the relative growth of British public sector occurred on a step-like pattern rather than on a continuous basis. That is to say, the Government fiscal activities have risen step-by-step to successive new plateaus during the period, due to the impact of major social upheavals like war and depression. These upheavals create a “displacement effect” resulting in the replacement of the previous lower expenditure and tax levels by new and higher budgeting levels. This displacement effect occurred several times during the secular period of study during 1890-1955 in United Kingdom.
Further, they also suggested that the social disturbance will force the people and the Government to inspect the efficiency and adequacy of previous measures to meet the problems which would have been considered trivial but which assume different dimension of urgency and importance due to social disturbance. All the factors that contribute for the increased public expenditure, are grouped under what Peacock and Wiseman call it as “inspection effect” associated with displacement effect.

During the period of their study, that have also discovered one more factor viz., “Concentration effect” involving public expenditures effected at various levels of Government which tend to concentrate in the Central Government. This happens when a country undergoes the process of economic growth. The concentration effect is different from displacement effect, in the sense that it operates in the normal as well as disturbed times.

National Studies on Public expenditure

Apart from the studies relating to international aspects, there are studies which focus attention on general issues of Public expenditure pertaining to India. Some of the important studies on Public expenditure of India are as follows.

T. Mathew's (1972) study on Public expenditure covered the period from 1937 to 1956. It analysed the patterns and various components of Public expenditure and their impact on economic development of the country. In this study he attempted to examine whether the changes in the pattern of Public expenditure were due to the deliberate Fiscal Policy of the Government or it were the outcome of several factors and circumstances that were within the perview of the Government.

K.N. Reddy (1972) attempted in his study to analyse the secular nature and time-pattern of growth of Public expenditure in India from 1962-68. In his analysis, he tried to examine whether Wagner's hypothesis and Peacock and Wiseman thesis can be applied to India.

The studies explained above examined the growth and pattern of Public expenditure of the Government of India as a whole and they did not explained the growth of Public expenditure of the regional Governments i.e., the State Governments in India.

**Regional Studies on Public expenditure**

The following are some of the important regional studies on Public expenditure.

J. Toye's study (1981)* covers the period between 1955 and 1970 and it examined the major changes that took place in the structure of Public expenditure of various State Governments in India over the period.

The study of Singh (1979) examined the growth and pattern of Rajasthan State Government expenditure during the period 1956-57 to 1975-76. The study examined the factors involved in determining the growth of Public expenditure and its financing.

Thimmaiah (1977) analysed, in his study various trends in growth of Public expenditure in Karnataka State and tested the hypothesis of Wagner.

The study of Raju (1989) examined the pattern and growth of Public expenditure of Andhra Pradesh on different functional categories during the period from 1956-57 to 1981-82. But it has not made any analysis about the determinants of Public expenditure and its growth.
The above studies have, undoubtly contributed to the growth of general literature on Public expenditure. But, they did not cover various aspects of Public expenditure like the determinants, factors responsible for observed trend, the effects of Public expenditure on regional and sectoral development and the like. There has been very little research analysing factors determining the disaggregated Public expenditure in a developing State like Andhra Pradesh which with its strong agricultural base provides an altogether different set of determinants because of its distinct levels of income and societal organisation. It is perhaps this sort of background at the State level that prompted Prof. Lakdawala to observe that "The positive aspects of Indian Public expenditure analysis remain a largely unexplored field."13

It can be observed from the above brief review of Public expenditure studies, no systematic effort has been made by any study to examine different dimensions of Plan and Non-plan, development and non-developmental expenditure of Andhra Pradesh during the period from 1980-81 to 1994-95. It is in this context that the present study has been undertaken to bridge the gap that exists in the literature on Public expenditure at State level in Andhra Pradesh.

**Need for the Study**

Public expenditure has become a focal point of study in the field of Public finance research. It has become a powerful tool of Public Policy ever since Keynesian system provided a conceptual frame work for State intervention, which made Government not only desirable, but opened the way for larger expansion of Government services and activities.

Government control and direction becomes necessary when the market mechanism fails to satisfy fully the hopes and aspirations of the people due to its imperfections and inadequacies. Thus, there is need for a well-designed public policy to guide, to correct and to supplement the market mechanism, resulting in the emergence of public sector, as an important segment of the economy.
Public expenditure is a reflection of man's desire for community living. Community cannot exist without certain common services. Public expenditure improving the living standards of yours and ours. The prevailing notion is that it is a remote technical topic, something to do with only the Government. The general public shows that their concern with the payment part of it and remain indifferent to other aspects of the problem. On the contrary, it is everybody's concern and it is for every one.

Public expenditure plays a crucial role in the economic development of a country. Through public spending, Government preserve and promote national/regional identity; and supply of infrastructure for further development. As such, they influence both the course of economic growth and the distribution of benefits and provide social services to meet the basic needs of population. Although public expenditure has increased at a higher rate than the growth in revenue resources (of several countries), public expenditure has not resulted in the attainment of much cherished goals of growth and equity. Hence, there is an urgent need to prune the growth of public expenditures, especially in developing countries.

In spite of the paramount importance of public expenditure in day to day life of the citizens and in the economic development of the country, its role has been explored less extensively than that of tax policy. This concern has been exercising the minds of several writers like Samuelson, Musgrave and others, who believed that the studies in the field of public expenditure are relatively few. Even in India, similar opinions have been voiced, as the area of public expenditure has not received as much emphasis as it deserves in Indian Public finance research.

The positive aspects of public expenditure analysis in India remain largely unexplored. However in the recent past, several studies were made on Public expenditure of India and related aspects. But, studies relating to growth of Public expenditure of State Governments in India are not many.
The present study, therefore, is a modest attempt in this direction i.e., study of growth of Public expenditure in Andhra Pradesh.

**Objectives of the Study**

The primary objective of the present study is to examine the growth of Public expenditure in Andhra Pradesh State, in the context of rapidly growing functions of the State Government and to identify the changes that have come about in the growth of public expenditure from 1980-81 to 1994-95. The following are the objectives of the study:

i. To analyse the growth of public expenditure in Andhra Pradesh.

ii. To examine the growth and changes in the structure of plan and non-plan expenditures.

iii. To examine the growth and changes in the structure of developmental and non-developmental expenditures.

iv. To identify the determinants of the growth of public expenditure in Andhra Pradesh.

**Hypothesis of the Study**

1. There is no change in the growth of plan and non-plan expenditure.

2. There is no change in the growth of developmental and non-developmental expenditure

3. The growth of Public expenditure is not responsive to the changes in its determinants.

**Data sources and Methodology of the Study**

The present study is both analytical and descriptive. The study is based on the secondary data mainly collected from the Budget documents of the Andhra Pradesh Government. The secondary data also collected from the following sources.
1. Reserve Bank of India Bulletins on State finances.


Information has also been obtained through personal interviews and discussions with the officials concerned of the Government of Andhra Pradesh.

The collected data have been analysed by using appropriate statistical techniques like averages percentages, annual compound growth rates and regression analysis.

**Period of the Study**

The present study is confine to a period of 15 years from 1980-81 to 1994-95. The reasons for the selection of this period for the study are as under:

1. The new 1980-81 series of State Net Domestic product and Per capita income are available only from 1980-81 onwards.

2. The figures of actuals for different variables used in the study are available only up to 1994-95.

Keeping the above constraints in view 1980-81 has been taken as the base year and 1994-95 has been taken as the latest year for recording the changes and growth in public expenditures of Andhra Pradesh.

**Chapter outline**

The present study has been divided into Five chapters. The First chapter explains the importance of the study, review of literature on the subject, need for the study, objectives and hypothesis of the study, data sources and methodology adopted in this study. The growth of public expenditure on plan and non-plan items and the
compositional changes in plan and non-plan expenditures is presented in the Second chapter. Third chapter examines the growth of public expenditure on developmental and non-development items and the compositional changes in developmental and non-development expenditures. The determinants of public expenditure and their influence on the growth of public expenditure is described in the Fourth chapter. Summary of research findings and conclusions are presented in the last chapter.

References

