CHAPTER 1

Introduction

Classical Economists opined that the government should not interfere in economic life of the people. The government should concentrate only on maintaining law and order. In modern times the principle of public expenditure is that the government should spend more to accelerate the tempo of economic development of the country. In developing economies the government should stimulate growth process in the absence of private initiative in the economy which requires higher levels of government expenditure. This role has been emphasised by Burkhead and Winer who states, “For a developing economy the growth structure is more likely to reside directly in the public sector. The developing country will observe responsibilities for economic planning and hence for the provision of infrastructure development that impose a heavy burden of government expenditure”. (Burkhead and Winer 1971).

The theory of state functions has changed drastically over a period of time. In the earlier days the function of the state is to maintain law and order and now the concept of welfare state, is more prominent. Under the concept of welfare state the state has to retain full employment and committed to an enormous extension of state activities for providing security from the cradle to grave.
Besides, the concept of welfare state has led to a considerable expansion in government activities both intensive and extensive schemes. This has resulted in huge increase of government expenditure. Increased public expenditure in developing countries have been explained by the factors such as enhancement of cost of defence, national security against foreign aggression, growth of population, urbanisation, growing concern of the state in the welfare of the citizens, the problem of maintenance of full employment condition and so on. Thus modern theory of public expenditure makes it clear that no economy can attain higher levels of economic development without accepting the role of public expenditure in modern economy.

Public expenditure holds the same question in the discussion of public finance as planning holds in the study of economic development. "Just as consumption is the end of all activities, so public expenditure is the end of all fiscal affairs of the state". (Mehta and Agarwal 1960). The government resorts to expenditure and revenue programmes to produce desirable effects on the national income, production and employment. Public expenditure also expands the volume and the rate of investment in both public and private sectors and increase production in all sectors of the economy.
A plan scheme of public expenditure provides an optimum resource allocation and reduces inequality in the distribution of resources by properly directing the expenditure towards education, medical and health care of the low income groups. Besides, by proper public expenditure policy, inflationary pressure can be contracted. The attainment of the above goals of the state government depends on the fiscal policy of central government and autonomy of the state government in raising revenue and spending. Based on the above importance and drastic changes in the concept of public expenditure, the present study formulates the following problems.

**Problem Setting**

The public sector has been assigned a key role in the economic development of underdeveloped countries. Hence, there has been rapid expansion of the public sector in a developing economy like India. As Hicks (1965) aptly points out, “The rapid expansion of public sector is now a universal phenomena”.

Adolf Wagner (1958) has established a functional relationship between industrialization and the relative importance of public sector activities. According to Wagner's law, the expansion of public expenditure is in proportion to the growth of gross national product. This is due to the fact that the government has to perform a number of functions more efficiently, which has led to an intensive
growth in public activity thereby increasing government expenditure while Keynesian Macro economic theories assume that public expenditure causes national income (Keynes, 1936).

The above two divergent views have different policy implications. Under the Wagnerian approach, public expenditure is a behavioural variable with a passive role. Under Keynesian approach, public expenditure is treated as an exogenous policy variable and it is mainly formulated to ease out short-run cyclical fluctuations. Hence, there is a need for an empirical testing before choosing between the two approaches. In addition, there is also a chance of a feedback pertaining to the relationship between public expenditure and national income.

Empirical works such as Peacock and Wiseman (1965), Gupta (1967), and Gandhi (1971) have examined the nature of relationship between public expenditure and national income by assuming national income as an exogenous variable. Besides, their works did not investigate the causal directions between public expenditure and national income, which address controversial approaches of both Wagner and Keynes. In this direction the works of Sahni and Singh (1984a, 1984b), Afxentiou (1986), Ram (1986, 1987), Singh and Sahni (1986), Sayed et. al (1989), Holmes and Hutton (1990) Afxentiou and Apostolos (1991) and Bhat et. al. (1991) are worth mentioning. Results of these studies are
diversified in nature which may be due to the difference in the procedure of causality testing and adequacy and comparability of data. Besides, the above works are related to national and international level and their relevance to the state economy like Kerala is limited due to vast differences in their socio-economic and political features. Hence, one of the issues of the present study is an inquiry of the causal nexus between public expenditure and state domestic product in Kerala.

Secondly, the growth of public expenditure is influenced by multifarious factors such as income, tax revenue, density of population, unemployment rate, urbanisation, grants, inflation, public debt, weaker sections of the society and political party in power. In this context, the studies such as Sacks and Harries (1964), Hoffman (1969) and Hutton (1974), Henning and Taussig (1974), etc. are worth mentioning. In respect of the influence of political factors on public expenditure, the studies such as Govinda Rao (1981), and Sham Bhat and Uma Sanker Patnaik (1991) are also worth mentioning. But these studies considered dummy variable as a proxy for quantifying political factors in identifying its influence on public expenditure. The quantification of political factors through dummy variable is questionable on the ground that it leads to the problem of errors in measurement and it is not possible to identify the exact change of government expenditure whenever political party in power changes. Hence, it is
better to quantify the political factors as percentage of elected representatives of the one party to the total elected representatives in an year. This is justified on the following ground :- (i) The state government and central government allocate certain amount for each constituency development through elected representatives and it will normally be spent in the constituency on the rationality of vote maximising principle. (ii) The majority of the ruling party in recent times is very thin. Shifting of loyalty of a few Members of Legislative Assembly or Members of Parliament from one party to the other results in changes in party in power. Hence, due weightage has to be given for the opinion of each Members of Legislative Assembly and Members of Parliament in policy formulation. Based on the above rationality, even a single study does not exist in identifying the socio-economic and political determinants of public expenditure in a regional economy like Kerala. Hence, the second issue of the present study is an investigation of the socio-economic and political factors which influence different components of state expenditure in Kerala.

Objectives of the study

On the basis of the issues mentioned above, the present study investigates the following objectives:
(i) To sketch the earlier literature pertaining to public expenditure and to identify the gap of such studies.

(ii) To elucidate different tools employed by the earlier authors to verify the theories of public expenditure and to identify the path in which the entire works proceed.

(iii) To examine the trend and pattern of various components of public expenditure in Kerala.

(iv) To identify causal nexus between state expenditure and economic growth.

(v) To identify the socio-economic and political determinants of various components of state expenditure in Kerala.

Methodology

Simple ratios and percentage methods are employed to examine the trend and pattern of state expenditure of Kerala. Besides, linear growth rate of various components of per capita expenditure at current and constant prices are computed to examine the trend of various components of state expenditure. Wholesale price index at 1980-81 prices are considered to convert nominal expenditure into real expenditure.
Granger, (1969) Sims, (1972) and multiple rank ‘F’ tests* are employed to examine the validity of Wagnarian hypothesis pertaining to Kerala state.

Log linear multiple regression equation are estimated to identify the socio-economic and political determinants of various components of state expenditure of Kerala and it is presented below:

\[ \text{PE}_i = a_0 + a_1 \text{PTR} + a_2 \text{PCI} + a_3 \text{PCD} + a_4 \text{UER} + a_5 \text{PUP} + a_6 \text{DP} + a_7 \text{PMLD} + a_8 \text{PG} + a_9 \text{PSE} + a_{10} \text{WPI} + a_{11} \text{SCST} + U \]

Where,

- \( \text{PE}_1 \) = per capita total expenditure,
- \( \text{PE}_2 \) = per capita total revenue expenditure,
- \( \text{PE}_3 \) = per capita revenue development expenditure,
- \( \text{PE}_4 \) = per capita social and development expenditure,
- \( \text{PE}_5 \) = per capita expenditure on irrigation,
- \( \text{PE}_6 \) = per capita expenditure on public works,
- \( \text{PE}_7 \) = per capita expenditure on forestry,
- \( \text{PE}_8 \) = per capita expenditure on transport and communication,

* The details of Granger, Sims and Multiple Rank F tests are explained in Chapter - 5.
\[\begin{align*}
\text{PE}_9 &= \text{per capita expenditure on housing and urban development.} \\
\text{PE}_{10} &= \text{per capita non-development revenue expenditure.} \\
\text{PE}_{11} &= \text{per capita expenditure on administrative services.} \\
\text{PE}_{12} &= \text{per capita total capital expenditure,} \\
\text{PE}_{13} &= \text{per capita development capital expenditure,} \\
\text{PE}_{14} &= \text{per capita non development capital expenditure,} \\
\text{PTR} &= \text{per capita tax revenue,} \\
\text{PCI} &= \text{per capita state income at current prices,} \\
\text{PCD} &= \text{per capita debt,} \\
\text{UER} &= \text{unemployment rate,} \\
\text{PUP} &= \text{percentage of urban population,} \\
\text{DP} &= \text{density of population,} \\
\text{PMLD} &= \text{percentage of Member of Legislative Assembly of Left Democratic Front to total number of Member of Legislative Assembly in state Legislature,} \\
\text{PG} &= \text{per capita grants,} \\
\text{PSE} &= \text{primary sector contribution,} \\
\text{WPI} &= \text{wholesale price index,} \\
\text{SC&ST} &= \text{percentage of scheduled caste and scheduled tribe in total population,}
\end{align*}\]
\[ a_1, a_2, a_{11} = \text{parameter to be estimated, and} \]

\[ \epsilon = \text{random error term}. \]

Besides, step-wise regression analysis was carried out to overcome the problem of multicollinearity and the equation selected for the analysis is on the basis of higher \( R^2 \) value and larger number of significant explanatory variables.

**Data Source**

The necessary information for the analysis were collected from various issues of Kerala Budget in brief, Economic-Review of Government of Kerala, Basic Statistics relating to Kerala Economy and Reports of annual plan of Kerala economy for the year 1957-58 to 1996-1997.

**Limitations of the Study**

The main limitations of the study are presented below:-

i) The results of the entire study are limited to the state of Kerala for the year 1957-58 to 1996-97.

ii) Results of causality test are restricted to the assumption of stationarity condition at first difference level of time series data,
iii) Results of socio-economic and political determinants of public expenditure of Kerala are also limited to the extent of existence of simultaneous relationship between the determinants.

Plan of the Study

The present study consists of seven chapters and it is briefly presented below:

Chapter one deals with introduction, Objectives. Methodology, Scheme and Limitations of the study.

Earlier literature pertaining to verification of Wagner’s law of public expenditure and determinants of public expenditure is presented in Chapter two.

Theories of public expenditure pertaining to our studies and various tools employed in verification of the theory by the earlier experts were presented in chapter three.

Chapter four deals with the trend and pattern of various components of state expenditure.

Causal nexus between public expenditure and state domestic product of Kerala is examined in Chapter five.
The socio-economic and political determinants of various components of state expenditure of Kerala are explained in chapter six.

Chapter seven presents the summary and conclusion of the study.
References


