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1.1. Introduction

In the early eighteenth century, economics and political science were the subject matter of political economy. In course of time, economics and political science were separated as branches of political economy. In the same manner, public finance as a branch of economics got separated from it. But the demarcating line between them is by no means final and complete. The contents of the science of public finance are divided into two broad categories – public revenue and public expenditure. These are comparable with the two fundamental categories of production and consumption in economics. In public finance, public revenue is divided into public revenue proper and public debt.

Public expenditure may be defined as the expenses of the public authorities—central, state and local governments. Public authority has to incur expenditure on various areas for the promotion of socio-economic development of the people. As the expectation of the people has grown, public expenditure has also been growing fast. Public expenditure is universally accepted as an important factor that forges ahead of development and growth in every economy. This role of the government is reinforced by several thinkers who are increasingly of the view that far more great social justice can be promoted by a sensible public expenditure policy.

Expenditure includes capital as well as current expenditure. Public expenditure involves the behaviour of the government in relation to the pattern of such expenditure. It is a branch of public finance, consisting of study of the money spending activities of the state or central or local governments from the financial point of view. It studies how the expenditures are incurred or how should it be spent to enable the state in performing its activities according to its desire.
However, public authorities at all levels are facing problems in finding adequate resources for financing these state activities. These problems can be solved either by increasing revenue or by proper management of public expenditure. Thus, public expenditure is one side of this problem. Therefore, it is necessary to know the determinants of the growth of public expenditure. Some of these determinants may be policy variables, which the government can manipulate meaningfully to achieve the desired objectives.

Colin Clark, in his Critical Limit Hypothesis, states that when public expenditure reaches 25% of the total economic activities, i.e., the total amount of expenditure in the country, the payer's ability to pay tax is exhausted. Any further increase in public expenditure, therefore, means disincentive to the producers and fall in production due to taxation beyond tolerable level. The increase in government expenditure would constitute rising demand, ultimately resulting to inflation in the economy.

Even though India is now one of the most highly taxed countries of the world, the ratio of tax revenue to national income is only 23% due to poor built-in-flexibility, high collection costs and not highly productive tax structure, which ultimately lead to insufficient revenue collection. Consequently, increase in public expenditure in the one hand and low revenue collection on the other have resulted in a widening of resource gap year after year. Problems are also aggravated by the pattern of financing public expenditure relying heavily on taxation of goods and public borrowing.

Economic theorists have done work of high quality in the field of taxation. However, public expenditure seems to have been relatively neglected. Economists specialising in the field of public finance were fascinated more by problems of raising revenue by taxation than by public expenditure. Commenting on the inadequacy of the theory of public expenditure, Samuelson, Musgrave, Goffman etc. have observed that the study of public expenditure has received far less attention.
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The study of public expenditure was neglected in the nineteenth century due to the belief that all public expenditures were wasteful. This idea was directly due to the writings of classical economists, particularly Smith, who advocated that the government should restrict its activities to justice, police and arms. Smith further held that government expenditure was normally wasteful. Economists and Statesmans of the nineteenth century came under the influence of Adam Smith and expressed similar opinions. Ricardo stated, "If you want peaceful government, you must reduce the budgets". He also supported the maxim of J.B.Say, 'The very best of all plans of public finance is to spend little and the best of all taxes is that which is least in amount' [1].

Thus, the study of public expenditure was more or less neglected till 1920 when the importance and significance of public expenditure were realised. There are some theoretical and institutional problems responsible for the neglect of public expenditure, which are given below:

1. An important feature of public expenditure programme is the lack of appropriability. Such problem of non-appropriability does not exist in the case of taxation. The benefits of public expenditure go to all but it is difficult to ascertain the response of individual behaviour generated by public expenditure. In short, the effect and efficiency of public expenditure on distribution is very difficult to assess.

2. Even if the output of some public expenditure can be made appropriable, one faces the difficulty of estimating the value to be attached to them. Most of the programmes of public expenditure are undertaken as a result of market failure and in this situation, observed prices are either nonexistent or poor indicator of economic values.

3. In a democratic form of government, the public expenditure decisions are divided not only among various departments and committees, but also among different levels of government. Such an institutional set up which influences expenditure decisions has also contributed to slow down the development of the economics of public expenditure.

4. Till recently, no serious efforts were made to evaluate the costs and benefits of government expenditure programmes either after its implementation or while it was in progress.

5. Another important factor responsible for the neglect of public expenditure was the feeling that the level and structure of expenditure were determined politically and were, thus, beyond the scope of economics.

6. There was a lack of readily accessible information about the composition and incidence of public expenditure programmes. The very nature of most of the public expenditures is such that it becomes difficult to trace beneficiaries or exactly to pin point their operational characteristics.

The above cited points indicate the main reasons for neglect of the economics of public expenditure by the economists. Till date, economists have not yet been able to provide a theory of public expenditure comparable to the established theories like theory of consumer behaviour, theory of market behaviour, theory of taxation etc.

1.2. Development of the Economics of Public Expenditure

In accordance with the spirit of the age, modern governments are welfare states and their functions and responsibilities are continuously expanding. These functions cannot be discharged in the absence of a proper correlation between finance or revenue and expenditure. There is, however, widespread agreement
that the role of government is important and that its role is in a large measure, determined by economic, political and social factors. Therefore, the subject of the economics of public expenditure has attracted the attention of not only economists but political scientists and sociologists also. As a result, both theory and practice of the economics of public expenditure have undergone a radical change since 1950. Now there is growing awareness regarding the effects of public expenditure on the size and composition of national output, the allocation of resources and the distribution of national income. It would be very interesting to know the factors that have contributed to the recent emergence of the economics of public expenditure as a distinct field of economic enquiry.

The following factors may be mentioned regarding the needs of the study of the economics of public expenditure:

1. The development of welfare economics in the field of economic theory calls for the interference in the market economy by the government and provide guidance for the choice of instruments to accomplish social objectives.

2. Efforts have been made to find the functional and theoretical relation and appropriate rules for the guidance of the government in respect of evaluation of the public expenditure.

3. For the development of LDCs like India, the appropriate criteria for investment in public sector needed a set of concepts, which was being developed in the literature of public expenditure.

4. There were growing demands for the expansion of government activities in all models of state during the 1950's and 1960's and public expenditure actually increased rapidly during these decades.
Taking into account the resource constraints, many public decision-makers sought for an economic criterion to aid them in choosing efficient policies among the available alternatives. This necessitated more and better knowledge of economic effects of public expenditure in the economy. These considerations have contributed to the growth of research in the field of economics of public expenditure. Today, public expenditures are instruments in promoting policy objectives rather than tools for merely financing the government activities.

1.3. Legislative Control Over Public Expenditure

Increase in government’s functions is a continuous process and every year a new item is added to the list. The police state has been replaced by the welfare state [2]. Expansion in government activities in the recent years has resulted to consequent rise in public expenditures. Every increasing quantity and variety of government activity is a characteristic of a welfare state. For a welfare state, having planned economy and a republican constitution like India, it is essential to have a machinery to control the administrative system. As White points out that power in a democratic society requires control and greater the power, the greater is the needs for control. Finance has become the nucleus of state administration [3]. “All undertakings depend upon finance,” remarked Koutliya in his Arthasastra, hence far greater attention has been paid to finance. Finance is the centre of administration. Now a days the legislature has become the thermometer to read the democratic temperature of the country. Democracy itself permits the country to control the government expenditure. Financial administration/ control is of great importance because of tremendous increase in the amount of money spent for provision of public services and it is utterly essential that sound principles and techniques of financial administration be employed. In India, with its socialistic set up, there has been an enormous growth in government expenditure. Thus, legislative control over

3. ibid. p. 2
government expenditure has become important and vital from the democratic point of view.

1.4 Public Expenditure Management (PEM)

Public expenditure plays an important role as a fiscal weapon not only for accelerating the rate of growth of an economy but also for securing economic stabilisation. It serves the multifaceted objectives. The objectives are financial objectives, political objectives, military objectives, economic objectives, and social objectives. So, each item of expenditure must be judged by its purpose or objectives and it is further necessary to know, in each case, how far and to what extent the objective is being realised. From the beginning of 1990's both the central and the state governments have been facing the problem of resource gap. Since the early 90's, the quantum of deficits (Revenue deficit[4], Budget deficit[5], Fiscal deficit[6], Primary deficit[7]) of the central as well as the state governments had continued to rise. It was clearly stated that, 'The quality of fiscal adjustment is also important, as it draws attention to the composition of fiscal adjustment. The compression in the fiscal deficit during the current year has been attempted through a combination of an increase in revenues coupled with a reduction in expenditure. This deceleration in the growth of revenue expenditure has led to a decline in revenue expenditure to GDP ratio from 13.1 percent in 1995-96 to 12.9 percent in 1996-97. This favourable out-turn on the expenditure side is largely on account of containment of non-interest plan expenditure [8]' In such a situation of resource gap, it is very important and

4. Revenue deficit is defined as the excess of current expenditure over current receipts.
5. Budget deficit is defined as the difference between total of revenue and capital receipts and total of revenue and capital expenditure.
6. Fiscal deficit is defined as the difference between the net revenue receipts plus non debt capital receipts and the total expenditures including loans net of repayments.
7. Primary deficit is defined as the difference between fiscal deficit and interest payments.
crucial for a government to identify priority and non-priority areas of expenditures. In the context of countries of limited resources like India and her states, it is necessary to determine the priority sectors/areas in planning development expenditures. Under ceteris peribus, the prioritisation should guarantee a maximum rate of steady and balanced growth. Besides, this will depend on the available resources indicating which project can or cannot be undertaken within a stipulated period of time. This prioritisation of important sectors must also take into account the degree to which a given project will reduce a country’s dependence on foreign countries as well on the central government in case of sub national economies.

Even though the problem of rising deficits has continued since early 90’s, the proper steps and initiatives for the management of public expenditure were being taken from late 90’s. As a result of inadequate fiscal adjustment, it continued to be the most important problem confronting the national economy and sub national economies. The fiscal imbalance of the central government has been further exacerbated by growing interest payments, increasing levels of subsidies to unaffordable levels which actually didn’t reach the deserving and expected beneficiaries and surge in pension payments in recent years. These factors have contributed to rising revenue deficit and erosion in public savings thereby severely constraining government’s ability to undertake investment in infrastructure and social sector[9].

The conventional budget exercises have focused on allocation of resources to different heads, without taking into account how these government expenditures got translated into outputs and outcomes. Issues of efficiency require the consideration of whether the same outcome can be achieved at lower cost or

the same cost can produce better outcomes. A critical part of the budgetary reform must include the information on the relationship between expenditures and the corresponding performance in producing real results in determining the size of the budget and its allocation among different heads. There is need to bring performance budgeting or zero base budgeting as an integral part of the preparation and evaluation of benefits, both for the centre and the states. Thus, the management of Public expenditure should be guided by Economy, Efficiency, and Effectiveness (the three Es).

The budget 1999-2000 charts out a way of fiscal correction over a medium term with a view to eliminate the revenue deficit and reduce the fiscal deficit to below 2% of GDP. The budget has outlined a strategy to solve the problem of fiscal slippage encompassing medium term process of revenue and fiscal deficit reduction[10]. Till the middle of 90’s, the emphasis was given to resource mobilisation and taxation front of Public Finance neglecting the economics of public expenditure management.

For medium term management of fiscal deficit, the budget 2000-01 proposed to bring out an institutional mechanism, embodied in the ‘Fiscal Responsibility Act.’ Accordingly, the Fiscal Responsibility and Budget Management (FRBM) bill 2000 was introduced in Lok Sabha in December, 2000. The government proposed to compress the growth of aggregate expenditure through moderating the growth in revenue expenditure. Important factors that have contributed to the increase in fiscal deficit are - rising expenditure on salaries, unfunded pension payments, improperly targeted subsidies and stagnation in the tax - GDP ratio.

In the budget 2001-02, government adopted a six-fold strategy to achieve full growth potential. Among the six the expenditure related strategies are fiscal consolidation through stringent control of unproductive government expenditure,

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rationalisation of subsidies, and improvement in the quality of government expenditure. But, to cut down the public expenditure is not an easy task. Compression in the revenue expenditure has been made difficult by the contractual nature of sizeable chunk of revenue expenditure. As a result of this, the governments both central and states could not take immediate measures to eliminate deficits and control the public expenditure within one or two years. In this connection, the Eleventh Finance Commission (EFC) had recommended a monitorable fiscal reform programmes for all states. States like Karnataka, Maharashtra, Punjab and Kerala had already enacted Fiscal Responsibility and Budget Management Act in their state legislature. This enactment helped in providing a statutory backing to the fiscal reform process initiated by the state governments. Besides, the financing of the fiscal deficit is still largely through borrowing and other liabilities, which further worsens the fiscal health. Pension payments and interest payments are the fastest growing items of expenditure. Expenditure on pension is about 50% of the expenditure on pay and allowance. With increasing longevity, the situation is worsening. The problem is more acute in Manipur. Concerned over the rising and unsustainable expenditure on pensions, in the union budget for 2003-04, the government had announced a new system of pension and approved it on 23rd August 2003. This system provides for a defined contribution shared equally by government employees and the government [11]. The stance of fiscal policy set out in the union budget 2003-04 was indicated in a renewal of commitment to five basic objectives[12]. Among the five priorities, fiscal consolidation is the most important priority sector. The process of fiscal consolidation is being carried forward through tax reforms, expenditure

11. The new pension system is based on defined contribution. New entrant to the central government to make a monthly contribution of 10% of the salary and D.A., which will be matched by the central government. In this system employees have the option of a voluntary tier-II withdrawable account without any contribution. Employees to normally exit the system at or after 60 years of age.

12. Five priorities includes- poverty eradication, infrastructure development, fiscal consolidation, development of Agriculture including irrigation and enhancing manufacturing sectors.
reforms, progressive reforms of additional excise duty and expansion of service tax, debt restructuring and cash management and which are envisaged as integral element of fiscal consolidation [13]. Public Expenditure Management (PEM) involves determination of the size of the outlays on various programmes within the resource constraints at various stages of government decision making. A core element of public expenditure management (PEM) is cash management along with debt restructuring. Cash management involves conversion and optimisation of cash flow and a sensitivity to cash costs. Effective cash management involves - (a) forecast of receipts, disbursements and resulting cash balances within the governmental financial system on a high frequency basis. (b) strict control over cash inflow to minimise time lags between expected and actual receipts. (c) cash outflow control to prevent both late and premature payments and (d) minimising operating cash balances.

Debt restructuring operates on three fronts, viz., prepayment of external debts, buying back of illiquid high interest rate loans from banks and allowing state government to swap high cost central government debt with lower cost new borrowing. For this the government of India introduced the Debt Swap Scheme (DSS). Under this scheme, between the central government and the state governments, all the state loans from the central government bearing coupon rate in excess of 13% would be swapped over a three year period ending in 2004-05.

Public Expenditure Management (PEM) has focused attention on fiscal consolidation. An important institutional arrangement in this direction was formation of Expenditure Reform Commission (ERC) to suggest measures to strengthen expenditure management. The pattern of expenditure of the last few years reveals that on an average, about 19% of the total expenditure is incurred during the last month of the fiscal year. As a result of this, the government of India introduced the

Pilot Cash Management (PCM) system in union budget 2003-04, which adopted time slicing of funds released to permit convergence of expenditures with the availability of resource within the year [14]. Manipur is a special category state and the state's own tax revenue is far behind the expenditure needs. Public expenditure management (PEM) is an important instrument for the correction of fiscal imbalances and deficits on one hand, efficient resource mobilisation and proper tax administration on the other.

Actually, it is not the level of government expenditure that is a matter of concern but its composition [15]. Wages and salaries, interest payments, and subsidies account for a predominant share of government expenditure. Therefore, fiscal consolidation is not a question of expenditure reduction, but the manner in which such reduction is brought about, while at the same time promoting growth enhancing expenditure. This shows that restructuring of public expenditure is an important part of public expenditure management. Public expenditure should be restructured and needs to be reprioritised by pruning untargeted subsidies and exercising utmost economy in wages and salaries.

1.4.1 Public Expenditure Management (PEM) and Fiscal Responsibility and Budget Management Act (FRBMA)

Fiscal Rules have important imperative in the context of the need to restrain discretionary policies which have an inherent deficits bias. Fiscal Rules can be defined as the legislated or constitutional constraints on government deficits, taxes, expenditures or debts. Adoption of fiscal policies/rules commit the government to a deficit or debt reduction path into the future, thereby enhancing the credibility of the fiscal stance[16]. International experience shows that a number of countries facing the problem of widening fiscal imbalances, have introduced Medium Term Fiscal Adjustment plans through the adoption of fiscal rules.

16. RBI: Op cit. p. 51
Concerned over the deterioration in the fiscal situation, in 2000, the government of India had set up a committee for recommending a draft legislation for fiscal responsibility. Based on the recommendations of the committee, the government of India introduced the Fiscal Responsibility and Budget Management (FRBM) Bill in December 2000. In this bill, numerical targets for various fiscal indicators were specified. Parliamentary Standing Committee recommended the bill and further introduced it in Lok Sabha in April 2003 and passed it as an act in May 2003. The same was passed in Rajya Sabha in August 2003. The enactment of FRBM Act marks a watershed in fiscal reforms. The act provides an institutional framework for compelling the government to pursue a prudent fiscal policy.

The FRBM Act 2003, which became effective from July 5, 2004, required the central government to eliminate revenue deficit by March 2009 and to reduce fiscal deficit to an amount equivalent to 3% of GDP by March 2008. The rules in FRBM Act specified the annual targets for reduction of fiscal and revenue deficits, annual targets for assuring contingent liabilities as a percentage of GDP. The rule also prescribed the formats for the Medium Term Fiscal Policy Statement, the Fiscal Strategy Statement and the Macroeconomic Framework Statement. The main highlight of the FRBM Rule 2004 are:

1. Reduction of revenue deficit by an amount equivalent to 0.5% of GDP at the end of each financial year,
2. Reduction of fiscal deficit by an amount equivalent to 0.3% of GDP at the end of each financial year,
3. No guarantees in excess of 0.5% of GDP,
4. It specifies important fiscal indicators, such as revenue deficit, tax revenue, total outstanding liabilities as a percentage of GDP are to be projected in the Medium Term Fiscal Policy Statement, and
5. For budget transparency in the budget process, the government of India is
also mandated to submit the statements of receivables and guarantees and a statement of assets, at the time of presenting the annual financial statement.

The government of India set up a task force under the chairmanship of Dr. Vijay Kelkar to draw up the medium term framework for fiscal policies to achieve the objectives set out in the FRBM Act. The task force advocated a fiscal strategy based on revenue augmentation and front loaded efforts on revenue expenditure reforms in order to counter balance the contractionary efforts of fiscal consolidation. The task force also made specific recommendation for tax reforms, tax administration and expenditure management reforms. In the area of expenditure management reforms, the broad strategy suggested by the task force related to greater allocation for legitimate public goods as opposed to transfers and subsidies; greater focus on public goods outcomes rather than their expenditures.

1.4.2 Public Expenditure Management (PEM) and The Twelfth Finance Commission (TFC)

The Twelfth Finance Commission (2005-2010) was set up under the chairmanship of Dr. C. Rangarajan in 2004. The commission prepared its report according to its terms of reference. Regarding public expenditure management, the commission prepared its recommendation on:

- Restructuring Public Finance
- Fiscal Reform Facility

Restructuring Public Finance aims at macroeconomic stabilisation.

Achieving revenue account balance requires a broad analytical framework. The impact of the size and composition of government expenditure on growth, inflation, interest rate and external account has to be considered in a framework that takes into account relevant inter relationship and feedbacks [17].

The commission recommended multidimensional restructuring of government finances aimed at both the qualitative and quantitative aspects of managing government finances. In particular, Public Finance Restructuring covers the following:

1. Expenditure Restructuring relating to both its size and sectoral allocations aimed at removing inefficiencies arising from misallocation, design and implementation of scheme delivery services,

2. Rationalising subsidies by reducing their overall volume, increasing their transparency by making them explicit and improving their targeting and

3. Suggesting institutional framework including ceiling on debt and deficits and mechanism for their monitoring through state level fiscal responsibility legislation.

In restructuring public finance, there needs to make reference to the basic objectives of the government intervention in the economic activities, as also to the basic objectives for assignment of responsibility as between central and state governments. It is also important to relate government expenditures to outcomes in terms of quality, reach and impact of government services. The two key elements of restructuring government expenditures relate to augmentation of capital expenditure relative to GDP, focus on infrastructure and a reduction of central government's expenditures on subject listed as state responsibilities.

As recommended by Eleventh Finance Commission, an incentive fund in the form of Fiscal Responsibility Facility (FRF) was set up by the Ministry of Finance leaving 85% of the revenue deficit grant. According to eleventh finance commission recommendation, the remaining 15% which constituted part A, has been linked with the improvement in fiscal performance. As far as part B is concerned, its initial share of states was worked out on the basis of population. In introducing the scheme of FRF, government of India prescribed a single monitorable indicator for the purpose of making releases from the incentive fund.
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The FRF scheme was subjected to certain changes after its inception. For those states that were already in revenue surplus, it was felt that it would be adequate if with improving revenue balance, the state shows a commensurate improvement in its balance from current revenue (BCR) [18]. Some lessons learnt from the implementation of FRF are summarised as follows:

1. The facility encouraged the states to draw up medium term fiscal reform programmes (MTFRP) for the first time, which is an important development in managing state finances.

2. The facility of financing reforms was not available to those states which were beneficiaries of any structural adjustment loans from multilateral agencies. Thus, the recommendation of the Twelfth finance Commission facilitated the Public Expenditure Management.

1.4.3 Public Expenditure Management (PEM) and Government of Manipur

A memorandum of understanding was signed between the Government of Manipur and the Central Government. The government of Manipur presented a white paper on Manipur State Finances in July 2002 and Manipur Financial Status 2002. The white paper on Manipur State Finances [19] states that

'The government and semi government sector is the largest organised employment provider. Given the current economic environment, this is no longer sustainable. The organised private sector is very limited and as such the majority of the employment outside the government sector is in the unorganised and firm sectors. Due to this skewed employment structure, the tax base in the state is extremely narrow. The state's own tax and non tax revenues constitute less than 10% of the state's total annual receipts.'

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18. Balance from the current revenue (BCR) is defined as the difference between the current revenue receipts and current expenditures

The expenditure to be incurred far exceeds the receipts. The deficit is
eliminated through overdraft and ways and means advances (WMAs). The nature
and magnitude of the problem afflicting the state finances have become more
and more transparent in recent years and all related issues are increasingly being
debated across a wide spectrum in the society. There is growing consensus that
restoring the state fiscal health needs to be accorded the highest priority [20]. This
white paper was presented in the Legislative Assembly with a view to encourage
and in depth discussion on the fiscal status of the state and to help in building a
consensus on the corrective measures required to set the economy on the sustained
high growth path. The balance from the current revenues (BCR) is an important
indicator of the fiscal health of a state. It indicates the difference between the total
of revenues and the total of expenditures of the state under revenue account. Hence,
a positive BCR would be necessary in contributing something to finance the plans.
But this has been consistently negative over the plans under analysis since 1990-91
onwards for the government of Manipur. This shows that the state government
had encroached upon resources in capital account even borrowing is used to finance
the negative BCR. This negative BCR is due to three important factors viz, payments
of salaries, pension payments, and debt servicing.

The quantum of resources sucked up by these commitments has been
increasing every year. The core gap [21], similar to BCR, has been turning into
negative and the condition worsened in 1999-2000. The trend of core gap is moving
in the direction of BCR. The dramatic deteriorations in the core gap and BCR in
recent years have been reflected as deficits in the non plan revenue account which
is indeed the most disturbing feature in the state finances. This is the manifestation
of the inability of revenue receipts to keep pace with the revenue expenditure.

20. ibid., p. 2
21. Core gap is defined as the difference between non plan receipts and non plan expenditures of the state
government.
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The acute fiscal problem experienced by the state has compelled the state
government to seek regular recourse to ways and means advances (WMAs) and
overdraft from the Reserve Bank of India (RBI). The main factors of deficit in Manipur
are overstaffing and mismanagement of financial resources. As per direction of
the Twelfth Finance Commission, the government of Manipur enacted Fiscal
Responsibility and Budget Management Act 2005 (FRBMA) in 2005. The main
objectives of this enactment are:

1. to take appropriate measures to contain fiscal deficits at sustainable
   level,
2. to pursue policies to raise non tax revenue with regards to loan recovery,
3. to lay down norms for the prioritisation of expenditures mainly the
capital expenditures and
4. to pursue appropriate expenditure policies that would provide impetus
   for economic growth.

This act was passed with a view to provide the principle of transparency,
stability, predictability, responsibility, fairness and efficiency. But the problem is
that there is no empirical study, regarding the effectiveness of reforms,
memorandum of understanding and FRBMA Act of the Government of Manipur in
realising the goal of public expenditure Management in Manipur.

1.5 Short Review of Literature

Recent northworthy studies on public expenditure in India are Bhuyan (1984),
(2004).

Bhuyan (1984) studied the public expenditure of Assam from 1951-52 to
1978-79 by dividing the whole expenditure into five broad parts- viz., general
services, social services, economic and development services, civil work and
irrigation etc. and miscellaneous services. In his study, he found that the expenditure on General Services rose at the rate of 4 percent in 1952-53, 26 percent in 1955-56, and further rose to 501.08 percent in 1971-72 by taking 1951-52 as base year. He further observed that 22.63 percent of the variations in expenditure on General Services could be explained by the time trend. Regarding the expenditure on Social Services, he observed that it increased at the rate of 6 percent in 1952-53, 120.16 percent in 1955-56 and further rose to 1960.6 in 1973-74 with respect to 1951-52 as base year. About 40.77 percent of the variations in Social and Community Services could be explained by the time trend.

With reference to Economic and Developmental Expenditure, he noticed that it increased at the average rate of 155.51 percent and only 17.12 percent of the variations in Economic and Developmental Services expenditure could be explained by time. Further, the revenue expenditure on civil works had been consistently increased during the period 1951-52 to 1971-72, the rate of increase was worked out to be 52 percent and 89.21 percent of the variations was explained by time. Thus, the budgets of the government of Assam during 1951-52 to 1978-79 did not reflect any definite policy of the government. They were all made to meet the needs of the hour.

Kumar (1986) made an analysis regarding public expenditure with the help of some important indicators such as (a) compound growth rate of expenditure with respect to time (b) the marginal growth rate of expenditure with respect to NNP and (c) the elasticity of expenditure with respect to NNP. He explained the growth of public expenditure in two ways; firstly in money terms and secondly in real terms. In money terms, he noticed that there had been a striking increase in total government expenditure from 1950-51 to 1979-80. During the period, government expenditure increased by 32.87 times
and national income increased by about 9.46 times. In real terms, the prices increased by nearly five times between 1950-51 and 1979-80. Regarding this, his view was that increase in government expenditure and national income must be partly attributed to the rise in prices. He further observed that in money terms the compound rate of growth of total expenditure had been 12.3 percent per annum. The developmental expenditure recorded a higher rate of growth \( (g=13.3) \) whereas the non-developmental expenditure had been growing at a lower rate \( (g=10.8) \). In real terms, the overall rate of growth of public expenditure was 7.2 percent per annum. The relative importance of the growth of developmental expenditure was reflected in its rate of growth of 9 percent per annum against the rate of growth of 5.5 percent in the case of non-developmental expenditure.

Misra (1988) studied the expenditure of Gujarat from 1961-62 to 1978-79 in order to seek the optimal expenditure plans of the government and to work out the optimal expenditure outlays. The study emphasised mainly the social services sector (government expenditure in education, health, medical and family planning). He observed the following:

1. About 80 percent of government expenditure in education, health, medical and family planning went to relatively rich segments of the population engaged in industries, trade and business etc. in Gujarat.

2. The expenditure on education was more employment oriented followed by medical cum health and family planning in the sense of share of total expenditure going to employees.

3. A maximum of 3.4 percent of total expenditure in medical reached the beneficiaries in terms of material gains and this figure was only 1.6 percent in education. The rest was spent within the system itself.
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4. The government expenditures mostly went to business, trade and industry and its distribution was highly uneven over various months, which led to the fear of inflationary potential in government expenditure pattern.

Jalan (1993) analysed the public expenditure between 1960 and 1990, and he observed that the current expenditure of the government (central and states combined) increased from 11.8 percent of GDP to 23 percent. Total expenditure including capital expenditure, increased from 18.4 percent to 30 percent of GDP. Over the period the rate of increase in expenditure accelerated, particularly after 1974-75. During 1974-75, the increase in current expenditure was 2.5 percent point and increase in total expenditure was barely 1 percentage point. After 1975, however, there was a real explosion in expenditure. Current expenditure increased by as much as 7 percent points. He further observed that the total revenue also grew at an accelerated rate after 1975 but the increase was insufficient to cover the increase in expenditure. Revenue increased from an average of 14.6 percent of GDP during 1971 - 1975 to 20 percent during 1986-1990. The difference between the expenditure and the revenue was financed largely by higher domestic savings. It is noticed from his analysis that the domestic borrowings increased from about 2.7 percent of GDP in the mid 70's to 7.3 percent at the end of 80's. As a result of the increase in domestic debt and interest rates, net interest payments by the government increased from 0.5 to 2.5 percent of GDP during this period.

Bhat (1997) analysed the determinants of public expenditure and revenue of the central government of India during 1960-61 to 1990-91 by using log-linear multiple regression equation and he further tried to verify the hypothesis that changes in political party in power influenced only the size of government expenditure by using dummy variable having ‘0’ for Congress regime and ‘1’ for non-congress regime. The analysis revealed that the size of public expenditure of the central government of India was positively influenced by the
degree of openness and unemployment rate lagged by one year and negatively influenced by the density of population, primary sectoral contribution and urbanisation. Further changes in political party in power exhibit significant influences only on the size of public expenditure but not on the size of tax revenue.

Mohsin, Naidu and Kamaiah (1995) tried to test Wagner's hypotheses using the data of Indian states. In their study they used the cointegration and error correction framework. They attempted to verify Wagner's law of increasing state activity in the context of 14 Indian major states for the period from 1966-67 to 1989-90. From the study they confirmed that all the time series data by and large were found to be stationary. The test of stationary were carried out by using Dickey Fuller (DF), Augmented Dickey Fuller (ADF) and Phillips Perron (P-P) tests. Further by using the Cointegration Regression Durbin Watson (CRDW), Dickey Fuller (DF), Augment Dickey-Fuller (ADF) and Phillips-Perron (P-P) cointregation tests, they found that there was no cointegration between income and expenditure except in the case of Bihar and West Bengal. In all the states, the hypothesis of no cointegration was rejected. The Granger test showed, except in few cases (Madhya Pradesh, Karnataka and West Bengal) that the findings were not supportive of any causal relationship between income and expenditure. Using the concept of error correction models the causal linkage in all the chosen states except in Uttar Pradesh was revived. Thus, they confirmed that Cointegration-Errors Correction Mechanism validated Wagner's law in the states such as Karnataka, Haryana and West Bengal.

Kumar (1995) studied the trends of the expenditures of government of India from 1951-52 to 1994-95, the post liberalisation era. He observed the following:

1. For the period from 1967-68 to 1987-88 the total expenditure increased by 1463 percent at the annual compound rate of growth (ACROG) of
14.7 percent and for the period from 1970-71 to 1990-91, the total expenditure increased by 1782 percent at an ACROG of 15.8 percent.

2. In both the periods, social service sector was the highest growth sector, which showed an increase of 2528 percent and an ACROG of 17.8 percent during 1967-68 to 1987-88 and an increase of 2480 percent and an ACROG of 17.6 percent during the period 1970-71 to 1990-91.

3. For the period 1950-51 to 1993-94, the development expenditure increased by 30595.7 percent at an ACROG of 14.1 percent at current prices. On the other hand, the non-development expenditure increased by 19649.4 percent at an ACROG of 12.9 percent.

4. The provision for payments of subsidies in central budget increased by a substantial amount. It was almost negligible in 1971-72. But the provision for three major subsidies viz., food, fertilizer and export stood at Rs. 8300 crores in 1994-95.

Chelliah (1996) observed that the response of the central government, in general, was not to control the growth of unproductive expenditure and the mushrooming of subsidies but to raise additional resources by increasing tax rates whose basic structures were in need of reform. He further observed that the rising fiscal deficit and monetisation of a substantial proportion of it led to inflationary pressures and growing deficits in current account of the balance of payments. He further observed that in 1989-90 the fiscal deficit was as high as 7.8 percent and revenue deficit was 2.6 percent of GDP, while the budget deficit, which was close to the monetised deficit was 2.3 percent. But in 1990-91 the revenue deficit had risen to 3.5 percent of GDP, with the fiscal deficit of 8.3 percent and budget deficit at 2.1 percent.

Sodani and Gupta (1998) studied the health care expenditure at household level for both rural and urban segments of the tribal area of Rajasthan. From this
study they found that the health care indicators were simple but powerful to estimate the nature and extent of direct and indirect expenditure born by households for getting treatment. Further, they confirmed that the household sector of the economy was the main contributor in financing of the health care in India, and health insurance was not universal; health planners and policy makers would have to pay more attention on how to reduce the financial burden of households for getting treatment specially in tribal areas. The health expenditure both direct and indirect born by the households were far too high and people in tribal areas had no other way but to approach poorly equipped and low quality private facility when they were confronted with serious illness.

Ganguly (2000) analysed the budgetary data from 1950-51 to 1998-99. In his analysis, he estimated that the rate of growth of revenue expenditure during the five yearly periods ending 1955-56, 1960-61, 1965-66, 1970-71, 1975-76, 1980-81, and 1985-86 were 27.1, 87.3, 145, 57, 126, 102.4 and 136.6 percents respectively. It was also noticed from the analysis that the rate of growth of revenue expenditure (17.4 percent) was more than that of revenue receipts (8.4 percent). The most important reason for continued increase in revenue expenditure was the increasing interest liability of the central government on its debt and other liabilities. The expenditure on interest payment varied between 31 percent and 36 percent of total revenue expenditure during the period from 1991-92 to 1998-99 (BE). The share of interest payment in total revenue expenditure was substantially more than that in the pre-financial reforms period up to 1990-91. Besides, it was also observed that the rate of growth of interest payment varied between 14 percent and 24 percent during the period from 1991-92 to 1998-99 (BE); the rate remained below 20 percent except in 1991-92 (24 percent) and 1994-95(20 percent). Regarding subsidies the study observed that the expenditure on subsidies increased by 364 percent during the decade from Rs. 1278 crores in 1977-78 to Rs. 5980 crores in 1987-88. It was further noticed that in post-financial reform period, the share of
expenditure on subsidies in total revenue expenditure had declined. However, as compared to the total expenditure of Rs. 12121 crores on subsidy in 1990-91, in 1998-99 it rose by more than double. The rate of growth of expenditure on subsidy had increased considerably since 1996-97. When the financial reforms were started, the rate of growth of subsidy was comparatively less in 1991-92, 1992-93, 1993-94 and 1994-95. This shot up to 22 percent in 1996-97, came down slightly to 19 percent in 1997-98 but again went up to 27 percent in 1997-98 (BE). Regarding capital expenditure, no uniform pattern emerged in the growth of either the capital expenditure or capital receipts. There was an increase in capital expenditure from Rs. 29122 crores in 1991-92 to Rs. 57865 crores in 1998-99 (BE), an increase of almost 100 percent.

Premchand and Chattopadhyay (2004) studied the trends and structure of public expenditure in India. During the course of their study they found that the total expenditure of the centre peaked in 1986-87 and was marginally over 20 percent of GDP; while revenue expenditure and capital expenditure were 13.03 percent and 7.03 percent respectively. Since then, total expenditure had gradually come down by more than 4 percent points, the share of revenue expenditure remaining the same. It is further noticed that during 1996-97, total expenditure fell below 14 percent but rose again along with the rise in revenue expenditure. Regarding the states they observed a similar picture. State’s total expenditure rose steadily during the 1970’s and 1980’s till 1987-88 and was stable afterwards at around 16 percent, though it fell temporarily from 1995-96 to 1998-99. The gap between the share of revenue expenditure and capital expenditure had been widening between 1980-81 and 2000-01, the share of revenue expenditure edged up by 3 percent points whereas capital expenditure declined by more than 2.5 percent points.

Sarma (2004) studied the pattern and share of central and state governments in India from 1950-51 to 2001-02. He gave much attention to the
period 1992-93 to 2001-02. He observed that between 1992-93 and 2001-02, central government expenditure registered an annual growth rate of 13.4 percent and corresponding growth for the states was 14.4 percent. Total government expenditure declined from 17.4 percent of GDP in 1992-93 to 15.3 percent in 2001-02; largely because of the shrinkage in the share of plan expenditure. He further observed that from 1992-93 to 2001-02, the non-plan revenue components of the central government expenditure registered average growth rate of 14.2 percent and 15 percent respectively and during the same period, states' total expenditure grew at an average annual rate of 14.4 percent while non-development share increased at an annual growth rate of 18.6 percent. He also observed that one of the most important factors that had adversely affected the quality of government expenditure was the over emphasis on expenditure rather than physical achievements.

Dholakia (2005) attempted to develop a multidimensional index for measuring the fiscal performance for the states. A composite index called the FPI was constructed by using eight different fiscal indicators. This study showed that the successive finance commissions of India had not been in a position to provide adequate incentives to all the states to become fiscally efficient. As a cumulative effect of such policies, fiscal crises started in the states since 1985-86. The calculated value of FPI for different post reform years for the 14 major states of India suggested that there was significant inter-state variations and deteriorations in the fiscal performance of states during the post reform period. The value of FPI for the rich states like Gujarat, Maharastra and Haryana was above 70 during 1990-95 compared to states like Bihar or Orissa where FPI was less than 40 during the same period. However, during the post reform years, the FPI of all major states deteriorated and the rate of deterioration was by and large higher among those states, that were known to be 'good fiscal performers' in the pre reform era.
Seenuvasan (2005) analysed the magnitude of expenditure and its composition at the state level. The share of different expenditure categories had been worked out in relation to aggregate expenditure of the respective state governments. During his analysis he noticed that there was no definite form or classification of public expenditure. The classifications were mainly dependent on time and situation. In the aggregate expenditure of all the states, development expenditure constituted a higher share than non-development expenditure and non-plan expenditure accounted for higher share than plan expenditure.

Ramesh and Nishant (2006) have studied the public and private health care expenditure and found the following:

1. The analysis of public health care expenditure suggested that state governments had targets of allocating only about 0.43 percent of GSDP to health and medical care.

2. The analysis further found that GSDP elasticity of health expenditure was 0.68 which meant that for every one percent increase in GSDP, public expenditure had increased by around 0.68 percent.

3. This study suggested that Private Health Care Expenditure (PHE) had grown substantially faster than real incomes. For each one percent increase in real PCI (Per Capita Income) the real per capita expenditure on health had gone up by 1.95 percent. During the last decade, PHE had grown by 18 percent per annum in nominal term and about 11 percent in real term.

Some of their important findings were:

1. Financing mechanism and provider payment system: The way in which health care expenditure was financed had important implications for the health delivery system. About 4 to 5 percent of total health expenditure was reimbursable under any insurance or reimbursable schemes. Studies had shown that in the absence of reimbursement mechanisms, people borrow substantially to finance health care.
Chapter - I : Introduction and Significance of the study

It was debatable whether people are getting value for their money, especially in illnesses where the financial burden is high.

2. Production function of private health care services delivery system: Data on the private sector suggested that many health facilities were small in size. Given the morbidity and mortality, India will need more resources to meet the health needs of the population. However, without any regulation and monitoring of the performance of private sector health care, it is possible that additional income buys costlier treatments at the margin, which produces a little impact on health outcomes.

3. Demographic trends and epidemiological transition: Due to the major demographic and epidemiological transition in the second half of the 20th century, India’s middle income group has vast base of around 250 millions. The proportion of households in the low income group has declined from 58.8 percent in 1990 to 49 percent in 1996 and the middle and higher income group has increased from 14 percent to 20 percent.

4. Dwindling financial support to public health system: India has created a huge system of public health services delivery but more than 60 percent of the health budget is spent in the recurring cost of staff salary. Social sector allocation are all absorbed mainly by staffing cost.

Tulsidharan (2006) analysed the annual data on government final consumption expenditure as a measure of government's size and Gross National Product (GNP) at market price in nominal and real terms of India for the period 1960-61 to 1999-00. He analysed the data by using the methods of integration, cointegration, error correction models to indicate bi-directional causality between government final consumption expenditure and GNP at current and constant prices. The data at current prices reflected uni-directional causality from GNP at market prices to government final consumption expenditure. He confirmed from the study that in nominal term,
higher economic growth invariably was accompanied by an increase in government final consumption expenditure.

1.6 Objective of the study

This study proposes to have a detailed discussion of the following objectives:

1. To analyse the pattern of growth of various expenditure heads of the government of Manipur,

2. To explore the main factors behind the growth of public expenditure in Manipur,

3. To examine whether these expenditures help in the realisation of objectives of economic planning,

4. To propose an efficient expenditure policy of Manipur and

5. To forecast the time series variables of different heads of public expenditure in Manipur.

An examination of public expenditure over a period of 30 years of planned development is expected to provide an opportunity for assessing whether the direction of public expenditure of Manipur is in consonance with the preferred objectives of planning. The impact of public expenditure on major sectors of the sub economy needs to be studied to form the basis for a rational public expenditure policy.

1.7 Research Methodology and Database

Two variables single regressions and multiple regressions are fitted to the data by the method of ordinary least square (OLS) to estimate the trends and fluctuations mainly in the expenditure of the government of Manipur for the said period. The different items of expenditure are regressed on time and the variations explained by the time factor have been found out.
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The study analyses the expenditures of Manipur both at aggregated and disaggregated levels. The head wise expenditure had also been analysed by finding growth rates of different heads by grouping the time series data into sub periods to find out the emerging pattern and structure of expenditures of the government of Manipur on different items.

Quadratic regression model, Dummy variable technique and statistics like CUSUM have been used to analyse the pattern of growth of different heads of public expenditure of Manipur to examine whether the variables are growing with stability or have any break in the growth pattern. Plot of recursive residuals and recursive parameter estimates are further used to confirm the stability and breaks in the growth models.

The budgetary data relating to India and other state governments as published from time to time in the RBI's bulletin and RBI's Annual report on currency and finance, Hand book of statistics on Indian Economy and other reports of the government of India are also used.

The linkage between expenditure and revenue is examined by using the Granger Causality and VAR model. In order to test Granger causality model the time series must be stationery and test of stationary is carried out by Augmented Dickey Fuller (ADF) test and Phillips Perron (P-P) test. Further, Elasticity model (Log linear transformation model) is used to verify the Wagner's law of public expenditure.

In order to find out the determinants of public expenditure in Manipur, log linear model, simultaneous equation models and ECM models are used. Besides, linear models, Log linear models, PDL and Keynesian models are also used to derive the impacts of different heads of public expenditure mainly on income (NSDP).
Chapter- I: Introduction and Significance of the study

This study tries to forecast public expenditure data by using single equation models, simultaneous equation models, ARIMA model and VAR model. Thus, the research methodology adopted for the present study is a combination of empirical analysis and prescriptive analysis. Besides the above mentioned methods, statistical techniques of time series analysis have been used. In finding the relationship between the variables, partial correlation method, Ordinary Least Square (OLS) methods and recursive least square (RLS) have been used predominantly.

The relevant statistical data for the thirty consecutive years from 1972-73 to 2003-04 have been collected from various official documents and sources. The major sources of data for the study are the various annual budget documents, various issues of Statistical Abstract of Manipur, various issues of Statistical Hand Books of Manipur, published by the Directorate of Economics and Statistics, Government of Manipur and other related documents for the period 1972-73 to 2003-04. Actual data from the budget documents for the periods covered by the study have been used.

1.8. Chapterisation

For the purpose of expository convenience and systematic analysis, the thesis has been divided into seven chapters, namely:

1. Introduction and significance of study,
2. Emerging pattern and trends of public expenditure in India,
3. Emerging pattern and trends of public expenditure in Manipur,
4. Determinants of growth of public expenditure in Manipur,
5. Impact of public expenditure on the objectives of economic planning
6. Forecasting of Public Expenditure in Manipur and
7. Policy implications and conclusion.
Chapter-I: Introduction and Significance of the study

In chapter-I, the problem of the study, Public expenditure management, scope and nature of the study and objectives of the study are explained clearly. Research methodology, data base and short review of selected literatures are given in the last portion of this chapter. In this chapter, concepts like FRBM Act, legislative control over public expenditure, fiscal reforms, latest finance commission reports are introduced.

Chapter-II discusses the changing pattern of public expenditure in India. The expenditures under different heads for the central, the states and combined are analysed separately. Pattern of growth of different heads are examined by calculating annual and compound growth rates. Breaks and instability in the growth patterns are also analysed using Chow test and CUSUM test.

Chapter-III deals with the pattern of growth of different heads of expenditure of government of Manipur from 1972-73 to 2003-04. By finding the Index number of expenditure heads, y-o-y growth rates, the pattern of growth is analysed. Using the same tests such as Chow and CUSUM stability in the time series is examined. The constant growth rates for stable time series are calculated for the entire period. For unstable time series, growth rates for different sub periods are calculated taking the year of break as the dividing year.

Chapter-IV discusses the determinants of public expenditure in Manipur. The main determinants are examined using the following models:

1. Log linear regression model,
2. Simultaneous equations model and
3. Error Correction Model

Chapter-V deals with the impacts of public expenditure on the objectives of economic planning. The impact of different heads of public expenditure are analysed using the concepts:
Chapter-I: Introduction and Significance of the study

1) Targets of public expenditure of different heads in terms of NSDP and total expenditure,
2) Public Expenditure elasticity,
3) Multipliers of different heads on NSDP,
4) St. Louis Model and
5) PDL and Keynesian models.

Chapter-VI discusses the forecasting of public expenditure based on time series data with different approaches. The approaches of modelling and forecasting using Single equation Regression model, Simultaneous equation model, ARIMA models, VAR model etc. are used to forecast the expenditure time series data and compare with actual. Some ex-ante forecasts are also provided.

Chapter-VII gives a short account of the findings, policy implications and recommendations of the study.