CHAPTER I

SELECTIVE REVIEW OF LITERATURE
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"It is the business of economics, as of almost every science, to collect facts, to arrange and interpret them, and description, definition and classification are the preparatory activities. But what we desire to reach thereby is a knowledge of the interdependence of economic phenomena. . . . . induction and deduction are both needed for scientific thought as the left and right foot are both needed for walking."

-- ALFRED MARSHALL

1.1 INTRODUCTION

Most government expenditure is financed by taxes, which not only raise revenue but also often constitute a major government instrument to influence income distribution. The effects of government expenditure on income distribution have received considerable attention in recent years. Therefore, fiscal incidence studies that estimate for a specific country at a specific time who benefits from expenditure and who is burdened
by taxes have become increasingly common. Historically public finance has been dominated by the theory of taxation. The emergence of public expenditure studies on par with taxation is primarily due to development planning in the Third World. Since the focus of the present study is on public expenditure at the State level, only a few studies at the theoretical level are examined.

1.2 Wagner, Peacock and Wiseman’s Studies

The two widely debated hypotheses concerning the behaviour of public expenditure are:

1) Wagner’s law of expanding State activity in the early 1960s, and

2) Peacock and Wiseman’s displacement effect a hundred years later.

Adolph Wagner, the famous German Political Economist postulated that a functional 'cause-and-effect'

relationship exists between the growth of an economy and the relative growth of the public sector. According to Wagner relative growth of government sector is an inherent characteristic of industrialising economies. He illustrated this with the examples of Great Britain, the U.S.A., France, Germany and Japan and came to the conclusion that as per capita income and output increase in industrialising nations, the public sectors of these nations necessarily grow in proportion to total economic activity. The 'chain-reaction' circumstances described by Wagner are that social progress leads to a growth in government functions which, in turn, leads to absolute and relative growth of governmental economic activity. The second type of activity refers to increased supply of public goods. The demand for these goods increases along with an increase in income during the period of industrialisation.

Alan T. Peacock and Jack Wiseman point out three serious defects in Wagner's law:

1) It is based on an organic self-determining theory of State which is not prevailing in most Western countries;

2) It omits the influence of war on governmental spending;

3) It stresses a long-term trend of public economic activity.

Peacock and Wiseman stress the time pattern of public spending. Their analysis involves three related elements. These are displacement, inspection and concentration effects. Using empirical data for the British economy after 1890, they observe that the relative growth of the British Public Sector has occurred on a 'step-like' rather than on a 'continuous growth' basis. An inspection process occurs whereby existing problems are more clearly defined with potential solutions more carefully studied during a major disturbance; and a concentration process whereby the central government becomes a larger proportion of the aggregate public sector. This disaggregative analysis as regards the growth and pattern of public expenditure seems to be more helpful in influencing public expenditure decisions as compared to Wagner's law.

Further, Peacock and Wiseman approach also indicates the permanent influences on government expenditure. According to them, technical change, population change
and change in prices and the level of employment are important factors that affect the volume and pattern of government spending. Although, the diversity of these possible general influences upon public expenditures is apparent, it is pointed out by them that the behaviour of public expenditure over any period depends on factors that can differ in importance from time to time and between one country and another. Therefore, they cannot give rise to any sort of general hypothesis about public expenditure.

The findings of Peacock and Wiseman for the United Kingdom as well as subsequent studies which have been published clearly relate the displacement effect to two major phenomena, namely, the two World Wars and the great depression. The developing countries are not altogether immune to such social upheavals.

6. See related references to this chapter.


3.1 Viverka's study on the United Kingdom:

Viverka, in his study of public expenditure in the United Kingdom presents a historical survey of the growth of public sector covering broadly two centuries. In this study the changes in the size and structure of the public sector are linked to other historical developments such as changes in total wealth as indicated by estimates of gross national product and changes in population. The growing share of public sector in the national output is supported by the following statistical findings. Government expenditure at constant prices grew at 2.7 per cent on an average for the period 1790 to 1960, whereas total output grew at only 2 per cent which is consistent with a value of the elasticity coefficient of one or even more. This difference is accounted for by the productivity lag in the public sector. Viverka also points out the irregular time pattern of growth of public sector which is attributed to the changing structure of government expenditure. This is supported by the statistical evidence of the

income elasticity of individual categories of public expenditure differing very widely. Thus, the study points out that more realistic conclusions are derived by considering the relationship between individual components of government expenditure and economic growth than the aggregate expenditure.

3.2 Christine Andre and Robert Dolorme's study on France:

Christine Andre and Robert Dolorme⁹, in their time series analysis of the public expenditures and revenues for the period 1872-1971 in France, also cast doubt on the relevance of the two frequently proposed hypotheses. If Bird refers to the displacement effect as a 'structural break', Andre and Robert prefer to call it a simple 'threshold effect', the validity of which, according to them, is heavily dependent on critical assumptions. Their empirical study points to the irregular growth of public expenditure in France, marked by profound transformations by levels of administration, field of application and economic categories. They also suggest that a different approach to the explanation of public expenditure is needed which is to be based on historical dimension of the phenomenon and an explicit theory of the State.

Reynolds and Smolensky study\textsuperscript{10} gives interesting results. They used the incidence assumptions to apportion expenditures among households grouped by income level. The benefits of cash transfers are assumed to accrue to the recipients of those transfers, the expenses for elementary and secondary school education are distributed among income groups in proportion to the number of children under 18 in each group; and so on. General expenditures, whose benefits are to a large extent intangible and indirect, are distributed half according to the number of households in the group and half according to income. Their calculations pertain to three reference years, 1950, 1961 and 1970. They cover the expenditures of federal, State and local governments. The pattern is always the same. Expenditures are clearly pro-poor. That is, expenditures represent a much higher proportion of income for the poor than for the rich. The result should not be surprising. The three largest expenditure categories are general expenditures, education, and cash transfers. Half of the general expenditures are distributed on a per household basis and, therefore, represent a relatively

large share of a poor persons income. Also since children are likely to be more evenly distributed among households than is income, allocating education expenditures by the number of children will favour the poor. Finally, cash transfers, a large component of which is public assistance, is also pro-poor. Therefore, the poor gain relatively more from public programmes than do the rich.

3.4 Goffman and Mahar's study on Caribbean Countries:

Goffman and Mahar in their empirical study\textsuperscript{11} relating to six Caribbean countries consisting of Haiti, the Dominican Republic, Costa Rica, Panama, Honduras and Guyana state that the growth of public expenditure may be affected by the process of economic development itself. While the study reveals a general tendency for the public sector’s share of the community’s output (E/Y) to rise during the period under study it is very doubtful about the Wagner type income-expenditure relationship because of the large variations in the income elasticities within and among nations. They come to the conclusion that neither Wagner’s law nor the Peacock Wiseman displacement effect adequately explain the behaviour of relevant aggregates.

3.5 Thron's study for a sample of 52 countries:

Richard Thron's study\textsuperscript{12} presents the results of the empirical analysis for a sample of 52 countries. He presents the hypothesis that social forces which are closely related to the process of development are a major determinant of the observed tendency of public expenditure to rise faster than national product and that this rise in public expenditure has certain implications for the structure of government revenues\textsuperscript{13}. He examines the pattern and growth of public finances in these countries in terms of four fiscal propositions:

1) Government expenditures tend to rise at a faster rate of growth than national product or per capita national product;

2) that the proportion of total spending devoted to social spending tends to rise during the course of economic development;

3) the rate of growth of government revenues tends to equal the rate of growth of public expenditures; and

4) the proportion of total revenues raised through taxation tends to rise in the course of economic development.


\textsuperscript{13} Ibid., p.187.
He emphasises the view that the forces which shape the pattern of government expenditures and revenues emerge from the dynamic process of growth itself. Presenting cross-section studies of developing and developed, low growth and high growth countries, he states that low growth countries have a greater cross-section gross national product elasticity of social expenditures than high growth countries and developed countries have a greater social expenditure elasticity than less developed countries.

His propositions are substantially supported by empirical analysis. He particularly focusses attention upon the growth and changing role of the urban sector as an explanation of the growth in social expenditures.

3.6 Selowsky and Meerman studies on Colombia and Malaysia:

Selowsky and Meerman\(^{14}\) investigate primarily the distribution of public subsidy in education and health care, and the distribution of public utilities (electricity, water and sewerage disposal). Some evidence is presented concerning the distribution of public expenditure in other areas, such as agriculture, garbage collection, and street lighting; but it is far from compre-

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hensive, and both the authors deemphasise its importance. For the principal areas investigated, the methodology is broadly similar. Both commissioned sample surveys of various services, with about 4000 households being sampled in Colombia and 1500 in Malaysia. For education and health care, the public subsidy to a particular group was taken to be the cost to government budget. The approach to public utilities was rather different; in part because there was relatively little public subsidy involved, they simply estimated the distribution between households and then, by simple regression, endeavoured to distinguish between supply and demand factors in determining the distribution. Most of their results are presented by annual income group and town size (or rural/urban); Meerman, responding to Malaysia's ethnic diversity, also presents the results by racial group and region.

Not only their methodology but also, their results are broadly similar. The distribution of primary education is pro-poor, secondary education neutral and post-secondary education strongly pro-rich. Public health care in both countries (although organised on quite different principles both between and within the
countries) appears to be equally distributed. The better-off make more use of public utilities, partly because the demand for the services is elastic with respect to income (Meerman) or housing characteristics (Selowsky). None of this is very surprising, except possibly for health care. The geographical and racial distribution, however, is a little more unexpected, in Malaysia at least. Because of the government's explicit determination to favour Malays, rural areas (where they live) tend to do better in terms of public expenditure than urban areas (where the Chinese live). Services which involve public subsidy tend to favour the Malays; services which are charged at full cost are principally consumed by the Chinese.

1.4 INDIAN STUDIES

4.1 Studies by Mukherjee, Panchamukhi and Reddy:

Mukherjee's study\(^{15}\) is an exercise in the reconstruction of historical statistics and relates to the developments of the first half of the 20th century. Moreover, he "has not made any effort to go behind his statistical results to establish a theoretical link between aggregate economic activity and the activity of the public sector"\(^{16}\).


Panchamukhi presents the applied theory of public expenditure. He brings out the importance of cost-benefit analysis in the process of public expenditure. His study 'represents a step towards clarifying the economic aspects of the effects of expenditure on education and health, the knowledge of which is so essential for making rational decisions in these fields'.

Reddy in his first study has analysed a secular and time pattern of the growth of public expenditure in India from 1872 to 1968. His approach to the problem follows the path indicated by Peacock and Wiseman. In an effort to establish a theoretical link between the growth of public expenditure and the national income of a country, he has examined the applicability of Wagner's hypothesis to India. While examining the shorter periods (i.e., periods after the two world wars and Independence of the country), he sees the relevance and validity of the concept of 'displacement effect'.

Reddy in his second study covering the 25 year period from 1951 to 1975 reveals how expenditure in public sector increased during the period. He notes that expenditure per head varies from state to state.

To a very large extent, this variation is explained by per capita federal transfers to States up to 1962. Since then the influence of this explanatory variable has declined and this points to the fact that 'federal transfers moved by and large, in favour of relatively underdeveloped States'.

Reddy et al in their study\textsuperscript{20} analyse the growth of Central government expenditure (1950-51 to 1977-78) both in money and real terms, and the factors accounting for it. Several conceptual and statistical problems concerning the study of government expenditure have been exhaustively discussed. Contribution of increase in prices, wages, employment and volume of goods purchased to the growth of Central government expenditure has been quantified. Expenditure by different functional categories in real terms has also been examined, while an attempt has been made to estimate the income elasticity of the major categories of expenditure. Commodity composition of Central government purchases and a State government purchases, namely, Gujarat have been made and their impact on different sectoral outputs also has been estimated through the input-output matrix. Direct and indirect

output multipliers of government purchases have been quantified.

The study is confined to the Central government expenditure because classified budgetary data are available for a fairly long period for the central government only. Also economic and functional classification is available from 1966 onwards for the Central government only. Since the pattern of expenditure by various States is not uniform, they have undertaken a case study of one State — Gujarat because it has a well organised system of government purchases and the records of the purchases are well maintained. Following the positive approach they have carried the analysis depending upon several sources for their data base.

The authors plead that "the agenda of future research in this area should, inter alia, aim to make a more comprehensive study of public expenditure through the inclusion of the expenditures of State governments and tracing the growth of functional categories of expenditure over a somewhat longer span of time"\(^\text{21}\).

\(^{21}\) Ibid., p.126.
4.2 Machiraju\textsuperscript{22} develops a new concept of development taxation. The central thesis of the author is that at present the majority of the population being beyond the pale of fiscal tools should be brought into its ambit. At the same time, the author stresses the need for a policy which will take into account non-economic factors in developmental strategies. The problem of development formulated here is mainly in terms of the development of human resources. The salient features of the development concept that have been evolved for taxation in this book are: the adoption of the conditioning technique in taxation, rewarding conformity and penalising non-conformity and provision of incentives to extend the exchange economy. The development concept also shows the irrelevance of redistributive taxation in helping the country's poor.

Public expenditure under the development concept evolved in the book would be determined first, on the basis of maximum utilisation of labour and second, complementarity effect of investment. A major conclusion of the book is that equitable economic growth can be attained only if we think of equity at the investment end before income is generated. This approach helps in

\textsuperscript{22} Machiraju, H.R., Fiscal Policy for Equitable Growth: An Agenda for Fiscal Reform, The Macmillan Co. of India Ltd., Delhi, 1977.
circumventing the distributonal aspect of the intractable problem of economic growth. The second criteria would involve investment which is a pace setter for additional investment and investment directed at removing bottlenecks which would result in a rise in productivity.

4.3 Jha’s book has been divided into four parts. Part I - Modern Welfare Economics starts with an enunciation of a basic problem in welfare economics i.e., defining the Pareto frontier, choosing a point on it and devising adequate mechanism to reach this point. The role of market in reaching Pareto efficient allocation of resources has also been discussed. It further articulates an in-depth analysis of the effects of uncertainty and external factors on the efficiency of the market mechanism. In this part author has also taken up the problems of allocation of public good, the free-rider problem, demand revealing incentives, compatible allocative mechanism and some voting models of public goods. The author further elaborates social welfare function, Arrow’s impossibility theorem and related results, the utilitarian, neo-utilitarian and Rawlsian norms of justice. Part II - Aspects of the Economics of Taxation studies the

incentives, effects of taxes on labour supply, savings, risk-taking and investment. It further studies standard incidence theory in a static two sector model of general equilibrium, tax incidence in growing economies, the incentive effects of taxes in the presence of inflation and taxation of exhaustible resources. The author has also taken up the issues of direct/indirect tax controversy, the problem of optimal mix of direct and indirect taxes as well as the problem of optimal taxation in static economies. Part III - Applied Problems in Welfare Economics - considers macrofiscal policy typified by the works of Blinder, Solow, Turnovsky, Tobin and others. It also explains cost-benefit analysis and the problems of pricing the output of the public sector. Part IV - Some Problems of Indian Public Finance - analyses the problems of public economics in the Indian context. It further studies direct and indirect tax structure, recent policy issues, a review of Centre-State relations and the public sector in India.

4.4 Bhattacharya makes a regorous econometric analysis of major issues relating to inflation and growth in the Indian economy during the planning era. The main thrust of the study is on the detailed understanding of the macro-economic behaviour of the public sector which plays a critical role in the mixed economy of India.

In particular, the book analyses quantitatively some key issues relating to the trade-off between inflation and growth, public expenditure and deficit financing, money supply and inflation, government budget constraints and resource mobilization, saving and investment, sectoral resource allocation and sectoral growth, foreign trade, and capital flows.

Although this study is essentially an econometric exercise, it makes a special effort to develop an analytical model of the Indian economy. To begin with, it discusses the theoretical implications of government budgetary constraints for public sector revenue and expenditure on the one hand, and for output, employment, investment and prices on the other. A special feature of the study is that it shows how various government budgetary instruments and policies are interdependent on each other, and how these interdependences act as constraints on government policy options with respect to inflation, growth and balance of payments. The recent theoretical developments in 'government budget constraints' and their implications for stabilization policies are incorporated in both theoretical and empirical analyses in this book.
1.5 LOCAL GOVERNMENT AND FINANCE IN COUNTRIES OF THE COMMONWEALTH

5.1 Hicks' study on Local Governments:

This is a study of experiments in local government in a number of British territories. Since the last World War Local government has been regarded as a means, not only to political, but also to economic development. It had long been recognized that Local government has a value as an 'education' for democracy. It is easier for Local government than for national government to be 'close to the common people'. Moreover, the connection between the payment of local taxes and the enjoyment of local services is direct and obvious, which is often so difficult to see in the national budget. The author in Part I deals with the connection between Local government and economic development against the background of 'The New Policy' and the suitability of the different instruments of policy under the British system of Local government.

She deals with the backgrounds and beginnings of Local government upto 1940 in the West Indies, India.

and Ceylon and West, East and Central Africa. The transition to modern institutions in these territories is dealt with in Part III.

The most important part of this seminal work from our point of view is Part IV wherein the local budget accounts are explored. Using the comparative method the author devotes considerable attention to current expenditure; its size and functional breakdown, expenditure on administration, health and medical services, education, communications, natural resources and trading services. The capital account, its importance and form, functional breakdown and resource allocation and maintenance of works are analysed; current revenue patterns both in urban settlements and rural communities are dealt with extensively. The system of grants of different types - block grants, specific grants, and grants to assist capital formation are critically examined. Part V is devoted to 'Finance and Politics' wherein she deals with the relations of Local government with the Central government, the multifarious urban problems and the perennial problems of rural Local government. There is also a note on the training of personnel in local self government. It is a monumental work of a devoted scholar of world wide reputation.
5.2 Cuthbertson's study on London Boroughs:

Cuthbertson et al.\textsuperscript{26} examine the majority party of the local authority which is assumed to maximize the perceived welfare of the average resident in their area by choosing an appropriate mix of local publicly supplied goods and other goods, subject to the budget constraints of the authority and of the residents. The model is tested on cross-section data for the London Boroughs in 1971. Results are obtained for the differential impacts of changes in types of grants on Local government spending and taxation, and for the impact of changes in political control.

5.3 King's study on Local Government in Australia:

King\textsuperscript{27} makes a strong allocational case for a system of Local government when the benefits of public goods and services are not national in scope, strengthened to the extent consumers are mobile between localities and the system functions as a shaping analogue for public services. However, largely because of the openness of local economies, macro problems should be predominantly a central responsibility. Theoretically it

\textsuperscript{26} Cuthbertson, K., Foreman Peck, J.S., and Dripaics, P., A Model of Local Authority Fiscal Behaviour, Public Finance, 36(2), University of New Castle upon Tyne, England, 1981.

is difficult to conceptualise a government in the absence of a social welfare function, and for local jurisdictions this implies a distributional stance when local policies for transport, housing and education are formulated. Moreover, there is a distinction to be drawn between acting neutrally and ignoring equity altogether, concentrating on efficiency and leaving distribution to chance. Either way, it should seem the centre has to take on board what the localities are doing when it designs its own distributional policies.

The discussion on 'charges' gives a fair account of the literature specifically related to local government charging policy. What is surprising is the way in which the public utility pricing literature has been neglected by those working in the area. With a single distorting tax (on property), localities operate in a second best fiscal environment.

1.6 STUDIES IN THE U.S.A.

6.1 Bahl\textsuperscript{28} gives us a bird's eye view of the evolution of fiscal system over the last thirty years; provides a good overview of the fiscal health of the state-local sector and why some of American largest cities are

having so much trouble in balancing their books at the end, not just the beginning of each fiscal year and rightly stresses that the fiscal fortunes of American State and Local governments are inextricably intertwined with the cyclical and structural shifts in the national private economy, Bahl raises the important question of how far State-local sector will fare when the current baby boomers, who wanted local services, become in future elderly, and will want national income transfers for retirement and health care. And what might happen if we then overlay another round of baby boomers, as basis on our fiscal system? Bahl is rightly skeptical about the familiar policy panaceas for the ills of our local sector; down town revitalization, increased Local government productivity, and subsidies for local economic development. Instead he argues for a well managed national economy and hard-nosed fiscal management by local officials.

6.2 It is to Break’s credit, however, that his concern with pragmatic application has not dulled his ability to take theory seriously. Instead, he eagerly examines each new idea with an eye to the way it might actually be used by federal, State and Local governments.

Some of his suggestions are, in fact, quite far-reaching. He argues, for example, that a consistent application of the benefit principle of taxation to municipalities would involve: "the shift of all financing responsibility for welfare to state and federal governments and the split of school financing between those governments and parents, a restructuring of local government units to improve the geographical matching of programme benefits and tax burdens, an expanded use of public pricing for non-collective local government services and some school services, and the shift of general fund financing to a local value-added tax."

Break also shows a strong interest in recent theories of public choice which develop positive models of political behaviour. His interest is indicated both in his discussion of intergovernmental grants and in the urban fiscal system. As he recognizes, none of the public choice theories is a completely adequate response to the task at hand, but such theories do raise a set of crucial politico-economic research questions, e.g. "if government is widely perceived to be too big or too inefficient, what is the best remedy? would it be a change in bureaucratic and political incentive systems and institutions, or a change in power relations in the public sector?"30

30. Ibid., p.256.
6.3 Steven\textsuperscript{31} explains that State governments are becoming more fiscally prominent as the federal government cuts back its domestic non-entitlement programmes. This Report describes recent developments affecting State revenues and spending to provide a basis for understanding the current fiscal situation of the States. The weak national economy, the legacy of tax cuts enacted several years ago, and federal aid reductions have all played a role in creating a fiscal crisis for many States. The Report also discusses information gaps, issues for future research, and prospective future policies.

6.4 Chicone and Walzer\textsuperscript{32} examine factors influencing the structure of government services provided, the impact on numbers and the composition of revenue used to finance services, the importance of fragmentation in determining costs of the services provided and the perception of residents regarding quality of service. The study is limited to a set of governments within a single State, e.g. counties, townships, municipalities, school districts, and special districts, centred in Illinois. Some key findings are: constraints on Local governments by


State legislatures, such as tax rate and debt limits, create incentives for local officials to circumvent regulations for financing necessary services; property taxes as a percentage of total revenues of local governments are positively associated with governmental fragmentation; and greater responsiveness of small governments to needs and desires of residents in providing services.

1.7 INDIAN STUDIES ON STATE AND ALLIED FINANCES

7.1 Madalgi\textsuperscript{33} analyses 'the trends in State governments' expenditure in India since the Five Year Plans. The study covers the period extending from 1951-52 to 1965-66, which witnessed the completion of the first three Five Year Plans.

7.2 Thimmaiah\textsuperscript{34} has studied the growth and pattern of public expenditure in Karnataka and has taken a 21 year period, from 1957-58 to 1977-78. He tested a few theoretical hypotheses in the context of public expenditure of a particular State of the Indian Union. His results show that 'the growth pattern of public expenditure in Karnataka State is not linear'. Besides he categorises


\textsuperscript{34} Thimmaiah, G., Growth of Public Expenditure in Karnataka, Southern Economist, 1st Nov.1977, p.17.
various items of the public expenditure of the State under relevant heads.

The major purpose of the study\textsuperscript{35} is to identify the determinants of tax revenues and non-plan revenue expenditures of the States towards making their medium-term projections. The projections are made for the periods of award of the Sixth and Seventh Finance Commissions. These projections are not only more objective, but also compare better than those adopted by the Finance Commissions and, hence, could perform better as a basis of determining statutory transfers.

The States of Karnataka, Kerala, Orissa and West Bengal are chosen for the purpose of studying the time-series determinants. In the study, the economic determinants considered are the per capita income at constant prices, the proportion of primary sectoral income to State Domestic Product, and the consumer price index.

Projections of tax revenues and expenditures are made on the basis of time-series determinants analysis for four States. Besides making projections, the determinants analysis is employed to provide a better understanding of the changes over time in tax revenues and

expenditures of the States. The effects of various economic and political factors on the fiscal decisions of the States are also quantified. The analysis of the effect of changes of parties in power, the influence of their ideological leanings and the impact of their stability considerations on the fiscal outcomes of the States is quite revealing.

7.3 Nanje Gouda's study deals with the impact of public expenditure on the growth process and the growth mechanism in the State of Karnataka and the feed-back effects of growth on public expenditure and the revenue yields necessary to finance it. The author employs the macro-dynamic technique to study the growth process and to analyse the interdependence between growth and the budget components. He examines the allocation of public expenditure among different areas of investment in the light of the accepted criteria of investment and finds this allocation to have been prompted by political considerations rather than by rigorous economic calculus and argues that this has reduced the rate of growth of the State's economy, and reordering investment priorities would maximise the rate of economic growth and the tax yields necessary to finance expenditure.

The author makes a strong case for increasing developmental expenditure not only in absolute terms but also in relation to non-developmental expenditure. The aggregate resources being constant, the rise in the former means a fall in the latter. However, if the rise in developmental expenditure takes place it creates employment opportunities elsewhere in the economy and those who are displaced from previous employment due to a cut in non-developmental expenditure can be restrained and employed there. Furthermore, in a dynamic setting where allowance is made for growth there will be rise in the States income which results in larger tax revenue. The interaction between economic growth and the fiscal system is highly complex and needs probing. The allocation of resources in Karnataka does not satisfy paretinian conditions of optimality due to market failures and State failure; innumerable X-inefficiencies come in the way of attaining the optimum. Unfortunately, these factors are allowed decisive sway over decision-making and this accounts for the rate of actual growth falling short of the projected growth rate thus preventing the economy from realising the potential of growth to the fullest possible extent.
7.4 Reddy and Sudhakar attempt to estimate the direction of public expenditure from 1975-76 to 1984-85 in Andhra Pradesh. They are basically concerned with three issues:

i) Whom did government expenditures benefit?

ii) What categories of expenditures benefited which income groups?

iii) What was the direction of expenditures over a period of time?

Only "allocable expenditure" are covered and "non-allocables" which cannot be allocated to any specific income group, for example, expenditure on 'general services' like organs of State, fiscal services, interest payments and servicing of debt, administrative services, pensions and miscellaneous general services, which account for roughly 20 per cent are excluded. The concept of expenditure incidence employed in their study is not the same as one finds in theoretical literature. Clarifying the concepts and methodology they proceed with "Benefits received approach" while not altogether discarding the 'Money flow approach' and "Benefits valued approach". They also explain the

criteria for distribution of expenditure benefits among different economic categories/income groups—low, middle and high. Benefit incidence of social and community services in 1984-85 is compared with 1975-76. Primary education, secondary education, pre-University education, University and other major education, technical education, medical education, agricultural education, special education, sports and youth welfare and culture in the sphere of education are covered. Other areas covered include medicine, housing, urban development, social security and welfare and relief on account of natural calamities. They find that "per household benefits from social and community services went largely in favour of high income group, both in 1975-76 and 1984-85, and the benefit distance as between low, middle and high income groups came down from 5.11:5.27:89.62 in 1975-76 to 8.31:8.71:82.98 in 1984-85. That is benefit incidence inspite of being progressive (pro-rich) tended to reduce inequities during 1975-76 and 1984-85".38

Similarly benefit incidence of economic services, covering co-operation, agriculture and allied services, industry and minerals, water and power development, transport and communications and other general economic services and other grants-in-aid contributions is estimated. They conclude that "per household benefits from

38, Ibid., p.67.
them went mainly in favour of high income groups, both in 1975-76 and 1984-85, and disparities among different income groups widened. This can be seen from benefit distance as between low, middle and high income groups, which was 1.50:8.17:90.23 in 1975-76 increased to 1.50:6.93:91.57. That is, benefit incidence continued to be progressive (pro-rich)\(^{39}\). Their findings have far reaching implications for redesigning public expenditure policy.

7.5 The study by Shah and Srikantaiah\(^{40}\) focusses on the structure of subsidy as an instrument to alter the distribution pattern of both education and earnings in the framework of human capital theory. The entire question of education, earnings and personal income distribution has been analysed with reference to the graduates of Baroda University for the four benchmark years - 1961, 1965, 1970 and 1975. This study is based on a sample of 294 graduates who responded to the questionnaire. Respondents are classified into different categories based on socio-economic characteristics. From the point of their inquiry, issues relating to subsidy are of utmost relevance. They find that "general subsidy at any level of education is non-egalitarian seems plausible. But the same cannot be said of specific

\(^{39}\) Ibid., p.77.

subsidy which has appeared as an anti-dote. By emphasising the specific subsidies further and by making education service a little more competitive, it is possible to alter the current dubious role of subsidy by affirming its positive effect\(^{41}\). They further point out "that with regard to the general subsidy, the stratifier effect is much more pronounced than the equaliser effect. The specific subsidy, in contrast does have equaliser effect in the sense of higher per capita subsidy going to beneficiaries with low per capita income. It has reduced the educational distance between various classes and generations\(^{42}\)."

1.8 STUDIES ON ANDHRA PRADESH FINANCES

Chandrasekhar's work\(^{43}\) is based on his doctoral dissertation submitted to Andhra University. It relates to the fiscal problem of Andhra Pradesh and provides for some discussions at appropriate places to the situation in some backward States like Bihar, Kerala, and Uttar Pradesh. In analysing the problem of State finances in all its aspects there are some obvious limitation of methodology as well as data coverage. Starting with an exploration of the relationship between public finance


\(^{42}\) Ibid., p.15.

\(^{43}\) Chandrasekhar, S., Andhra Pradesh Finances, School of Economics, Andhra University, Waltair, 1983.
and development, he analyses the tax system and expenditure programmes in Andhra Pradesh. Public debt, contribution of public enterprises and transfer of resources from Centre to State are also examined.

The fiscal strategy for development of Andhra Pradesh is explained towards the end. He feels that a more intensive exploration of any one aspect of the problem would throw more light on the main and related issues. Kantha Rao's doctoral thesis also explores the same domain, the period of study, methodology adopted being more or less identical to that of Prof. S. Chandrasekhar.

1.9 CHOICE OF ANDHRA PRADESH

Andhra Pradesh is chosen because it is considered to be a State which is neither advanced nor backward. In other words it is a model State of the Indian Union and therefore, representative. Another reason is the access to data sources. With a view to making an assessment of expenditure level and structure in Andhra Pradesh, comparisons are made with neighbouring States as well as all States in regard to selected aspects of public expenditure.

1.10 METHODOLOGY OF THE PRESENT STUDY

10.1 Objectives:

i) to review the budgetary situation in India;

ii) to discern the trends of the select components
    of public expenditure in Andhra Pradesh vis-a-vis
    other States; and

iii) to assess the benefit incidence of housing, health,
    education and rice subsidy schemes in Kavali town
    of Andhra Pradesh.

10.2 Hypotheses:

i) there is no structural change and variation in
    the major components of Central expenditure in
    India during the period 1976-90;

ii) the growth in public expenditure is not faster
    than the growth in State Domestic Product in
    Andhra Pradesh;

iii) there is uniform growth in expenditure of economic,
    social and general services in Andhra Pradesh; and

iv) the benefit incidence of public expenditure on
    housing, health, education and rice subsidy
    schemes is not progressive in and around the
    Kavali town.

10.3 Data base:

Primary data are collected in and around the Kavali
    town for the purpose of examining the benefit incidence
of housing, health, education and rice subsidy schemes. The government hospital and Zilla Praja Parishad (ZPP) High School, Kavali were purposively chosen. Sixty patients, 82 students from ZPP High School and 47 from S.V.U.P.G.Centre, Kavali were randomly selected. 125 beneficiaries of rural housing around Kavali, 145 beneficiaries of rice subsidy scheme at Kavali were randomly chosen and data collected from the respective sampling units with the help of a structured schedule (Appendix).

Secondary data are collected from the reports, budgets and surveys of the government of Andhra Pradesh, India and the World Bank. The publications of Reserve Bank of India, mainly Reports on Currency and Finance and Bulletins are indispensable sources for any investigation in the field of public expenditure and the present study is no exception. Periodicals such as Public Finance, The Economic Journal, The Asian Economic Review, Financial Express, The Economic Times and Economic and Political Weekly have also been consulted.

10.4 Tools and Techniques:

Time series and cross-sectional data culled from numerous sources have been subjected to statistical treatment; measures of central tendency, dispersion, coefficient of correlation, and time series analysis
are widely employed. Linear and compound growth rates are also computed. Diagrams and graphs are drawn to illustrate the data.

10.5 Limitations:

A doctoral dissertation is a fragile tool to tackle the several complexities pertaining to the theory and practice of public expenditure. Our attention is confined to an examination of only the most established theories and hypotheses of public expenditure. It is rather difficult, if not impossible to attempt an exhaustive coverage of the burgeoning literature. It is now thirty five years since the formation of Andhra Pradesh. Our focus is restricted to the preceding fifteen years of the structure and trend of public expenditure in Andhra Pradesh. The earlier period is omitted partly because of the fact that there are a few studies pertaining to that period. The tools of analysis are also the most familiar ones; and the sophisticated econometric tools are not attempted chiefly due to my own limitations in that field. At most care is taken in the writing and presentation of the Thesis; there may be some lapses in terms of idiom and style which confront any student whose mother tongue is not English.
10.6 Chapter Scheme:

The study is organised into six chapters. The first chapter covers a select review of the literature related to public expenditure and the methodology of the study.

The second chapter deals with the role of public expenditure in economic development.

The growth and composition of government expenditure and fiscal imbalances in India are analysed in the third chapter.

Chapter four deals with the growth and structure of the public expenditure in Andhra Pradesh.

Chapter five attempts to evaluate the benefit incidence of expenditure on housing, health, education and rice subsidy schemes in and around Kavali town of Andhra Pradesh.

A summary of findings and conclusions is presented in the final chapter.