CHAPTER VII
SUMMARY AND CONCLUSIONS

7.1. INTRODUCTION

Public expenditure as a part of fiscal policy is an important strategy for economic development in India and elsewhere. Hence, the aggregate public expenditure and its several components have been manipulated in many countries to achieve several economic development goals. Despite its widespread impact and policy utility, public expenditure analysis is a relatively neglected area. Under the liberalized regimes, especially under the Structural Adjustment Programme (SAP), initiated in many developing countries, fiscal reform has been an indispensable part, to achieve macro economic stability and to hasten the pace of economic development as well. The policy makers would be interested in knowing about the changing structure of public expenditure, its determinants and impact in order to find out if the stated objectives are being fulfilled to the desired extent. That makes an obvious case for public expenditure analysis especially in the post reform period. Hence the present study focusing on India attempts to trace the changing structure of public expenditure.

The present study, with that purpose traces the changing structure of public expenditure in India with particular reference to the post reform period. The study also looks at the possible economic determinants and impact of public expenditure. The aspect of public expenditure management which now happens to be the integral part of the public expenditure reform process is also taken up for scrutiny. The data for the purpose is solely derived from the secondary sources, mainly from the Indian Public Finance Statistics, Economic Surveys and Budget documents, Government of India, and from RBI publications. For the analysis of the changing trends and composition the data was converted into constant prices, as percent of GDP and per capita terms. The exponential growth for the major items of public expenditure was also calculated. For the determinants and impact analysis the detrending of the data series was first carried out. Then the Granger causality test was applied to determine the direction of the causality between public expenditure and other important variables. Once the issue of the direction of causation was settled the simple and
multiple regressions were run for the determinants and impact analysis. The Chow test for the equality of co-efficients was used to analyse the impact of public expenditure during the pre and post reform periods.

7.2 LITERATURE REVIEW

Large number of studies within India and elsewhere has analyzed the various facets of public expenditure. However, the studies concerning India are not many and have not dealt with various factors in the period of economic reforms. The available literature, can be broadly categorized into four groups: i) Studies concerning trends and composition of public expenditure, ii) Determinants of public expenditure, iii) Impact, efficiency and productivity of public expenditure, and iv) Issues concerning the management of public expenditure.

7.2.1 DETERMINANTS OF PUBLIC EXPENDITURE

The studies pertaining to the determinants of public expenditure indicate that public expenditure at all levels is the result of complex set of socio, economic and political factors. The studies are available at the individual country level and groups of nations taken together. Bulk of the studies focus on demographic and electoral factors as explanations for public expenditure. Several other studies also cover economic determinants like inflation, revenue and its composition, type of economic policy regime, extent of decentralization etc. Among the demographic factors the size, composition, growth rate, density, urbanization etc. turn out to be important determinants. Many studies emphasize high positive correlation between age composition and public expenditure composition (Masson and Tryon, 1990; Scot and Sunny, 1991 etc). As the age composition changes either in favour of elderly or child population, public expenditure composition also turns in favour of items affecting these age groups (Johns and Falkingham, 1988). The changes in other demographic parameters also influence public expenditure composition in different ways (Eshevarria 1992; Kuijis 2000 etc).

Another important determinant of public expenditure is the political system and agenda of the polity in a democratic set up. Electoral constrains, partisan and opportunistic polity, ideology often lead to what is called as political cycles in public
expenditure. Studies show that public expenditure takes upward drift during elections (Easaw and Gurrett, 2000; Tridimas, 2001). This especially happens in highly visible areas of public expenditure (like schools, roads, etc) (Kneebone and Mckenzie, 2001). The expansionary fiscal policy to boost electoral prospects is especially found in countries that are less trade oriented and in the countries that pursue fixed exchange rate policies. The agenda of the policy and the electoral consideration often result in corruption and rent seeking activities. As Mauro (1966), finds these factors too influence, especially the composition of public expenditure. For instance, corruption is associated with higher military expenditure and lower expenditure on education and health care (Gupta and others, 2002). Corruption also affects the efficiency of public expenditure (Del Monte and Papagni, 2000). External factors like foreign aid, foreign savings, and donor conditionality also determine public expenditure size and composition (Gang, 1999). Public expenditure is found to be greater in countries with large foreign sectors.

The macro economic policy regime and objectives are also important factors. For instance the emphasis on macro economic stability results in fiscal discipline and moderate public expenditure. Extent of privatization or private participation in certain spheres of production (e.g., infrastructure) affects both revenue expenditure and capital expenditure (Compos and others, 2002). Commitment to poverty alleviation and its position in the overall policy sphere also has some bearing on public expenditure (Hefley and others, 1966). The fiscal policy stance especially the larger tolerance for the budgetary deficits, deficit financing also adds to increasing size of public expenditure (Diamond, 1987). The inflation (Opler, 1988), occurrence of business cycles (Goff, 1988), extent of centralization, decentralization and localization (Anderson and Hendrik, 1998) and expenditure of the neighboring countries (especially with respect to military expenditure), (Coller and Hoeffel, 2002) are also the factors influencing the public expenditure decisions.

The Wagner's Hypothesis, whether GDP causes public expenditure (or the other way) has been extensively subjected to empirical scrutiny, including many studies in the Indian context. However the results go in different ways - some studies support this (Thornton, 1999, Kolluri and others, 2000), while a few others do not find
validity for the same (Alleyne, 1999; Burney, 2002). The support or no support is found to vary according to the coverage of the study period, type of the explanatory variables and models considered.

The consideration of possible revenue constraints on public expenditure has led to two kinds of hypotheses. The first type namely, 'Spend and Tax' hypothesis incorporates that spending decisions are taken first and accordingly tax revenues are raised, and this finds support in many studies (Li, 2001; Ewing and Payne, 1998 etc). Whereas in the 'Tax and Spend' hypothesis, the size of tax revenue and its composition determines the public expenditure and its composition (Gordan and Wilson, 1999; Lean and Mascoll, 1994). There is also evidence of bi-directional causality between tax revenue and public expenditure.

7.2.2 ACT OF PUBLIC EXPENDITURE

If the numbers are an indication, then the Impact analysis of public expenditure is the most widely discussed and researched of all the aspects of public expenditure. Impact of public expenditure on various macroeconomic variables like GDP, employment, income distribution, external trade, money supply and inflation, poverty, welfare, crowding in/out etc., is considered by plethora of studies. Impact of public expenditure on income or output is the obvious starting point. However, the direction of causality between GDP and public expenditure is not clear, as seen earlier. More than the aggregate public expenditure its different components give better results in impact analysis (Hanson and Magnus, 1994). Economy's response to public expenditure also varies according to the way it is financed. In some cases, the distortionary taxes, public debt etc., retard growth, while the deficit and equity financed public expenditure positively affected growth (Dalamagas, 1992; Hasan and Siddiqui, 1994; Miller and Russek, 1973). In a more open economy, public expenditure also influences the output of imports and importables (Turnovsky and Sen, 1991). Public expenditure affects income and output growth through crowding out or crowding in routes which in turn depends on the composition and source of financing public expenditure (Levaggi, 1998; Ahmed and Miller, 2000). Expenditure on pure public goods, transport and communication crowds in private investment,
whereas expenditure on impure public goods and social security expenditure is found to have crowding out effect (Ibid). The tax financed expenditure was found to have crowding out and debt financed expenditure crowding in effect, as noticed by some studies. Public expenditure can also pull out (or push in) the economy from (or into) the business cycles (Alagoskoufis, 1987; Aziz and Leruth, 1997). Looking at the equity/welfare implications of public expenditure Scully, (2001) finds that a lower public expenditure or cut in public expenditure does not necessarily lead to lower welfare, thereby clearly making a case of public expenditure reduction. The financial sector variables like interest rates (level and structure) money supply and inflation are also greatly influenced by public expenditure, especially if it is debt financed (Fischer and Turnovsky, 1992). The external sector variables like exchange rate, BOP especially current account deficit, international competitiveness are also linked to public expenditure, and composition and the way it is financed (Ghosh, 1990; Bianconi and Turnovsky, 1997).

7.2.3 PUBLIC EXPENDITURE MANAGEMENT

Public expenditure Management and its several aspects is an area widely discussed are in the 1980s and 1990s, especially following the Fund-Bank purported Structural Adjustment Programme. Several studies talk about the budget reform both at budget making and implementation and need for the transparency in the process. (Heald, 1996; Pradhan, 1997). The studies suggest numerous measures like reassessment of the methodology, resource budgeting (akin to zero based budgeting) and also call for varied institutional reforms (Deadman and Mealli, 1998; Premchand, 1990). The studies also focus on the other aspects of budget like audit and accounting, financial reporting, adoption of corporate governance practices etc. PSU reforms as an inevitable component of managing public expenditure and has been analyzed by some studies. This mainly includes issues like offloading to the private sector (Harrison, 1989); public-private partnership (Premchand, 1999) so as to ease pressure on public expenditure; contracting out of public services to introduce ex-ante competition (Damberger and Jenso, 1997); PSU downsizing etc. Public Debt Management is also an important issue under public expenditure management where several options for better debt management are considered.
After the extensive review of literature, the present study lists the research gaps/sues with specific reference to public expenditure analysis in India. It noted that while large number of studies focus on analysis of trends and composition, the studies on determinants, impact and efficiency are found wanting, especially covering the post-reform period and at the national level. Then, after setting the objectives and hypotheses, the study gets into the core chapters.

7.3 HANGING STRUCTURE OF PUBLIC EXPENDITURE

The study of trends and changing structure of public expenditure is the starting point in most of the public expenditure analysis. This is true with the present study also, which looks into the changing structure of public expenditure of the Centre from 1960-61 to 2000-01. Keeping with the general practice and also in consonance with the availability of data, the study carries out the analysis according to the economic (revenue and capital expenditure) and the functional classification. While the study analyses the broad trends in the public expenditure at different levels—Centre, States and Combined, it is only the Central government expenditure that is subjected to detailed scrutiny and analysis.

7.3.1 BROAD TRENDS

The total expenditure of the Centre is broadly categorized into three phases: Phase I, covering the decade of sixties (1960-61 to 1969-70) is the decade of fluctuating fortunes, when public expenditure increased from about 10 percent to 15 percent of GDP, before coming down to the original level by the end of the phase. This period as noted in the determinants chapter, faced several exogenous shocks like war, droughts that influenced expenditure behavior. The II phase, covering the period 1970-71 to 1986-87 witnessed consistent increase, public expenditure remained at a high level of about 15 percent and reaching the highest ever peak of about 20 percent in 1986-87. During III phase, 1987-88 to 2000-01 public expenditure declined by over 4 percentage points and has since stayed between 14 and 15 percent of GDP. Hence the reduction process began in mid eighties, than in early 1990s, and for our purpose (as so opined by several other experts), post 1986-87 marks the beginning of the reform process. The eighties is also a decade which saw initiation of policies of
economic liberalization on a limited scale and also several measures aimed at expenditure reform. Hence economic reform must have had moderate impact on the quantum of public expenditure.

A detailed look at the components of public expenditure, viz., revenue expenditure and capital expenditure gives some interesting trends. During I and II phases, both the components followed the broad trends as that of the total expenditure. The behavior became divergent only in III phase during which revenue expenditure remained steady at around 13 percent (and increased at the end of the study period), while the capital expenditure continuously declined from a high of about 6.5 percent of GDP in mid-1980s to below 2 percent mark by 2000-01. Hence most of the contribution to expenditure reduction in the post-reform period has come through the compression of capital expenditure showing that the achievement is only quantitative, not qualitative in nature. The period starting mid-eighties also witnessed the emergence of revenue deficit, higher magnitude of fiscal deficits and fiscal profligacy of acute nature.

Behavior of the expenditure of the States follows patterns similar to that of Centre, except during Phase III. Total expenditure has steadily risen in the seventies and eighties and since has remained stable at around 15 percent of GDP and registered only a marginal fall temporarily for about four years since mid nineties. The capital expenditure has been declining, but due to the increasing share of revenue expenditure, total expenditure has remained almost unchanged. Combined expenditure of the Centre and States also treads a similar path. Total expenditure decline is not that significant due to stubborn behavior on the part of the total expenditure of the States. The revenue expenditure has risen, again at the cost of capital expenditure, which fell from a high of about 8 percent in mid-eighties to just about 3 percent in mid-nineties. Since 1997-98, both revenue expenditure and capital expenditure have been increasing the rise being sharper in case of the former.

7.3.2 REVENUE EXPENDITURE

As far the revenue expenditure of the Centre is concerned, nothing seems to be stopping its growth which during the study period has risen by about 30 times at
current prices, 15 times at constant prices and by about 2.4 times (i.e., from 5.5 percent to 13.5 percent) as percentage of GDP. Both developmental revenue expenditure and non-developmental revenue expenditure have risen and reached their respective peaks of 5 and 8 percent of GDP by about mid-eighties. In the nineties, developmental revenue expenditure declined by about 1.5 percent and non-developmental part only marginally by about half percent of GDP, before reaching highest ever peak of about 9 percent of GDP by the end of nineties. Interest payment is the largest item of both total and revenue expenditure and is more than the total developmental revenue expenditure. Defence expenditure that was above total developmental revenue expenditure (till 1976-77) and interest payments (till 1987-87) have been declining in the nineties. Subsidy, another major part of revenue expenditure from a low of less than half percent till mid-70s, reached a high of 2.15 percent of GDP by late 80s. The 1990s brought about successful revenue expenditure reduction in the subsidy bill by almost about 1 percent point. The pension payments that as negligible till 1987-88 has increased by about 20 times (at constant prices) since then.

Hence the decade of eighties has witnessed a very fast growth in revenue expenditure that ultimately led to the emergence of revenue deficit culture which continues to haunt our fiscal economy even today. The increased borrowings to bridge the ever increasing deficits resulted in the accumulation of debt stock (both internal and external). As a result, interest payment assumed top slot in the expenditure hierarchy. In the 1990s, as the interest rate on government borrowing has been linked to market rate that resulted in further increase in the interest expenditure both in absolute and relative terms. Most of the items of revenue expenditure reached their respective peaks by about mid-eighties (as percent of GDP).

The decade of nineties saw some positive developments when the total revenue expenditure, developmental revenue expenditure, defence and subsidy items registered decline. However the non-developmental revenue expenditure, pension payments have risen and continue to be cause of concern. Among the other items of non-developmental revenue expenditure (apart from interest payments, defence, subsidy, pensions, etc.) the expenditure in GDP terms on the 'Organs of the State has
double during the study period from 0.05 percent to 0.10 percent of GDP. The fiscal and administrative services have also registered upward movement. Expenditure on administrative services has particularly registered robust increase since 1980s and at 0.6 percent of GDP now is almost equivalent to pension payments, food subsidy and expenditure on agriculture and is more than fertilizer subsidy.

The total developmental revenue expenditure that gained momentum in the eighties and remained high even in the first half of nineties and has since declined. Among its major items include grants to states and union territories and expenditure on social and community services. The grants to states and union territories which has been the largest item of developmental revenue expenditure bill till mid 1990s has been taken over by social and community services. Grants to states and union territories from a high of about 1.7 percent of GDP (1987-88) declined to just about 1 percent of GDP. This defies the ground political reality (of coalition governments) during the period. The expenditure on social and community services from a peak of about 1.2 percent of GDP in 1987-88 declined till 1994-95 indicating the neglect of this sector - for a major part of economic reform. This since 1995-96, possibly in response to the demand for 'Reforms with Human Face' has picked up gradually, but is still below the peak reached in 1987-88. However, it is to be noted that Centre accounts for only about 20 percent of the total social sector expenditure, rest being accounted by the States. Among the other items of developmental revenue expenditure, the expenditure on fertilizer subsidy (as percentage of GDP), industry and minerals and general economic services have declined, whereas the agriculture and allied services, transport and communication, have increased their respective shares. Some important and largest heads of revenue expenditure viz., the interest payments, subsidies, defence and pension payments are taken up for detailed analysis.

7.3.3 INTEREST PAYMENTS

Though not an India-specific development, interest payments have emerged as the largest of public expenditure. In present Indian context this accounts for 35 percent of revenue expenditure, 50 percent of total expenditure and about 4.5 percent of GDP. It is also the fastest growing item of public expenditure and has thereby
increased its share over the years. In per capita terms, at over Rs. 60, it is more than the per capita developmental expenditure. The growth of this item which was steady till mid-70s (it was below 2 percent of GDP) picked up from the eighties and became sharper in late nineties. Interest payment is due to past borrowings and therefore regarded as 'committed expenditure'. The borrowings in turn in the Indian context are mainly the result of bourgeoning deficits. Increasing interest burden has reduced the government’s flexibility to spend on more productive items like capital and social sector expenditure. In fact, it has resulted in the crowding out of not only the productive public expenditure but also impacted more on productive private investment expenditure. Despite several steps suggested for containing the bourgeoning interest burden (especially the debt stock), there has not been much change in this aspect.

7.3.4 DEFENCE

Defence, is another major expenditure item that is incurred by the Centre alone. It is one of the largest items of public expenditure, though its share as percent of GDP has declined especially in the nineties. Despite this, the gross defence expenditure (revenue plus capital part) is more than the capital expenditure of the Centre. As percentage of GDP, it reached a peak in 1963-64 (following China war) and 1986-87 (both times at around 3.6 percent of GDP), went on an increasing spree between late seventies till mid-eighties, mainly due to changes in the security environment and reliance on imported equipments. From mid-eighties till about mid-nineties, it declined and reached a low of about 2 percent of GDP. Following Kargil war, it again pricked up and presently stands at about 2.5 percent of GDP and 6 percent of total expenditure. A notable feature of India’s defence expenditure has been knee jerk reaction of the policy makers to increase defence outlay in the years immediately following wars and the increase has been not sustained in the subsequent years. Of the total defence expenditure, the revenue component forms substantial part, and in the 1990s, however the capital part has increased its share. It is also noted that despite the strong strategic considerations, India spends less – in GDP terms- on defence sector as compared to China and Pakistan.
7.3.5 SUBSIDY

Subsidy component is a major expenditure item in both developed and developing countries, India being no exception. At about Rs.30,000 crore at the start of the new millennium it accounts for 1.5 percent of GDP and above 10 percent of total expenditure and 15 percent of the current receipts. It has risen from a low of 0.3 percent of GDP in 1971-72 to about 2.75 percent of GDP in 1989-90. However, the successful pruning of total subsidy bill has taken place in the nineties. Fertilizer subsidy accounts for the most (since 1983-84) followed by food subsidy. The export subsidy has been done away in the nineties, subsidies on other items accounts for about 5 percent of the total subsidy. The fertilizer subsidy, first introduced in late seventies, grew rapidly in the eighties, declined in the nineties, before stabilizing at about 0.7 percent of the GDP. Food subsidy accounts for about 0.6 percent of GDP and it is considered to be important from the view point of nutritional and food security. However, the efficiency in the usage of subsidy both food and fertilizer by way of proper targeting is suggested by several experts. More than the explicit subsidies, it is the implicit subsidies that is larger in volume and according to certain estimates, it stands at double the level of implicit subsidies, i.e., at about 3 percent of GDP for the Centre alone. It is considered to be at a much higher side at the state level.

7.3.6 PENSION BILL

Pension payments, presently at about Rs.14, 000 crore is about the half of the size of capital expenditure of the Centre. It has been increasing sharply since mid-90s and stands at about 0.7 percent of the GDP now. Taking due note of this development, Centre has initiated certain measures like the announcement of new pension scheme and setting up of a regulatory authority for the pension fund.

7.3.7 CAPITAL EXPENDITURE

The capital expenditure – one of the two broad economic categories, till about eighties, accounted for a sizeable chunk of total expenditure. In the sixties, its share was as high as 45 percent which by the end of nineties, was at a meager 15 percent of the total. In the first phase (1960-61 to 1967-68) it rose from 4.5 percent to 7.3
per cent of GDP. In the next three years, Phase II, it declined to just about 3 percent - the period when India faced acute droughts and BOP difficulties. However, during Phase III, consisting of 1970-71 to 1986-87, revival happened and from 3.3 percent rose to 7 percent. In the IV phase starting 1987-88 till 2000-01, there has been a consistent decline which is now below 2 percent of GDP mark.

Among the total capital expenditure the share of non-developmental capital expenditure has increased over the years and which now account for about 70 percent of total capital expenditure, compared to the developmental capital expenditure. The defence services (capital) account for the substantial part of the, other items (boarder roads and fiscal services) occupying only a smaller slot. Like the non-developmental capital expenditure, the developmental capital expenditure has also declined during the nineties. That includes items like railways, industry and minerals, transport and communication, etc. The near negligible share of industry and minerals (just about 0.04 percent of GDP) in the nineties clearly shows that in conformity with the reform ethos, no fresh budgetary injection has taken place into the PSEs of the Centre. Similarly, the share of railways, transport and communication, water, power and development has also declined in the post-reform period. Loans and advances, the third component of the capital expenditure that includes loans and advances given to the States has also declined to about half a percent of GDP from a high of 2.5 percent in 1990-91. The declining share of capital expenditure and the higher revenue expenditure resulted in several fiscal problems and as our impact analysis shows had adverse repercussion on the GDP growth.

7.4 DETERMINANTS OF PUBLIC EXPENDITURE

Public expenditure and its different components are influenced by vast set of complex socio-economic-politico-administrative factors. Economic determinants offer only a part of the explanation. In fact initially it was believed that public expenditure is fundamentally determined by the political considerations and this parameter even today continues to exert considerable influence on public expenditure decision making. However several economic factors too have bearing on public expenditure which is evidenced both in theoretical and empirical literature.
7.4.1 THE METHOD

Our analysis requires, as a first step to resolve the apparent conflict regarding the direction of causality between public expenditure and other variables considered as determinants. The testing of causality is carried out as per the procedure given by Granger (1969). Before the Granger causality test is carried out detrending of the whole data series was done in order to remove, the possible effect of the trend behavior of the variables.

There are several factors both economic and non-economic influencing public expenditure. However, the consideration of plethora of non economic determinants is outside the scope of this study. An attempt is made here to concentrate on some of the possible economic determinants that may have influenced the course of public expenditure in India during the period 1970-71 to 2000-01.

7.4.2 CAUSALITY TEST AND OUTLIERS

According to the results of the causality test the public expenditure in India is influenced by tax revenue, fiscal deficit, trade balance, external assistance and forex resources. While the causation runs from public expenditure to other variables like GDP, money supply and public debt. Results are found to be statistically significant at 5 percent level. In certain cases like demographic factors the direction of causality is obvious without requiring any causality testing.

The notable omission in the Indian context as a factor not causing public expenditure has been the GDP, as predicted by Wagner's hypothesis. This is contrary to the results found by other studies pertaining to the Indian economy. The differences in the results is due to difference in the study period, kind of models used and the type of explanatory variables included in the model. Among the fiscal variables only tax revenue and fiscal deficit are found causing public expenditure increases, whereas in case of public debt the causality runs in the reverse direction. Hence, 'Tax and spend' hypothesis holds true in Indian case. The tax revenue however is not the only factor to have contributed to public expenditure decisions. The tolerance to higher budgetary deficits has led to the emergence of fiscal deficit as another important causal factor. As the results also indicate, the extent of trade deficit and other external variables like
external assistance and forex have provided additional flexibility to the government to incur higher public expenditure.

7.4.3 DETERMINANTS OF PUBLIC EXPENDITURE IN INDIA

Drawing from the theoretical knowledge and Granger causality test, the determinants of public expenditure in India are categorized into four broad groups namely the economic factors (savings, capital formation, poverty and budgetary expectations; budgetary factors (tax revenue, deficit and total transfer to the states); and external trade factors (trade and current account balance, external assistance, forex reserves and trade to GDP ratio) and demographic factors (total population and total working population). Step-wise regression analysis all the above listed variables are found to be significantly influencing public expenditure in India. While the poverty, openness of the economy and trade balance is negatively related, all other determinants (as indicated by the sign of the slope coefficients) have positively influenced public expenditure. Each of the determinants is further analyzed in detail.

7.4.4 MACRO ECONOMIC FACTORS

Among the macro-economic determinants the availability of Gross Domestic Savings (GDS), forms a primary constraint on the size of public expenditure. India has internationally comparable level of savings. Prior to the year 1986-87, both public expenditure and gross domestic savings increased, the gap narrowing down, and have almost equalised in the year 1986-87. During this period public savings were also sizeable (but declining), tax- GDP ratio was increasing, dependence on ‘external’ assistance was declining and public debt was at about 40 percent for most of the period. All these factors with sizeable gross domestic savings provided enough cushion for higher public expenditure in both absolute and relative term. The GDCF also was increasing and stabilized around 24 percent by mid 80s.

In post 1986-87 coinciding with the reform period gross domestic savings continued to rise led by house hold savings, but public savings continuously declined and turned negative by the end of the study period. Gap between gross domestic savings and public expenditure widened. With the declining revenue receipts, but high level of public expenditure resulted in higher revenue deficit, increase in debt-GDP
ratio. Hence healthy level of savings even during this period despite the declining trend in public expenditure failed to provide cushion to the fiscal parameters thereby indicating detachment of dependency behavior between savings and public expenditure.

Higher levels of absolute poverty as is the case in India entail higher public expenditure. But that does not seem to have resulted in higher public expenditure. Budgetary Expectations also influence public expenditure decisions. This is confirmed in the occurrence of fiscal marksmanship and formation of budget estimates. The instances of fiscal marksmanship are galore in the Indian budgets indicating wide divergence between budget, revised and the final (actual) figures for a fiscal year. Budget estimates (referred to in our study as budgetary expectations) of previous year have signal effect. That is, previous year’s budget estimates of public expenditure (which are already over-estimated) would have influence on current year’s budget estimates, thus leading to the perpetuation of higher public expenditure. Hence the budget estimates are carried forward and public expenditure is perpetuated building upon the tendency of the previous year.

7.4.5 BUDGETARY FACTORS

Among the budgetary variables the tax revenue (led by indirect taxes) has set immediate constraint on public expenditure decision making in India. During the pre-1986-87 period, the total revenue, tax and indirect taxes steadily increased and reached respective peaks thereby providing enough leverage for the public expenditure increases too. The declining tendency of these parameters in the post reform period possibly has been one of the factors enabling or forcing public expenditure decline. However the financing pattern of public expenditure reveals that in the post reform period the current receipts have not kept pace especially with the high levels of public expenditure, hence leading to increasing reliance on the deficits which went on increasing leading to fiscal disorder. The ease with which deficits could be incurred (without experiencing any immediate adverse consequences in the short run) coupled with the inadequacy of the current receipts influenced the public expenditure.
expenditure decisions of higher magnitude (higher relative to the current revenue). This inevitably led to borrowings and hence addition to the debt stock.

The total transfer to the states (TTS) that includes all kinds of transfers from centre to the states viz., statutory grants to states, grants to states and union territories and loans and advances (net) also seem to have influenced the behavior of Public expenditure in India. TTS as percentage of GDP and public expenditure has declined especially in the post reform period, from it gradual increase till 1985-86. Its increasing trend contributed to the increasing public expenditure in the pre-reform period. The decreasing TTS in the post reform period has ably helped in the containing the public expenditure. This is surprising as it happened in the era of coalition governments at the centre with important role being played by the regional parties.

7.4.6 DEMOGRAPHIC FACTORS

Demographic parameters are the obvious determinants of public expenditure and its composition, every where. The total population and total working population have positively influenced the aggregate public expenditure in India. The higher population growth in sixties and seventies resulted in high public expenditure to GDP ratio. As the population growth slowed down in eighties and nineties, it helped in the public expenditure curtailment. However the working population, whose share in the total population that has increased in 1990s does not seem to have exerted any undue pressure on the public expenditure in the period.

7.4.7 EXTERNAL TRADE FACTORS

The relationship between the domestic economy parameters and external sector is widely recognized in the economic literature. Fiscal variables are also related to external variables both as explained explanatory factors. The extent of outward orientation of the economy (as reflected in total trade to GDP ratio) has a bearing on the economy. Prior to mid-eighties with smaller openness of the economy, public expenditure remained at high level and was increasing. As the outward orientation of the economy increased, mostly in the nineties, it had moderating influence on the public expenditure size. Hence, openness of the economy bears inverse relation with
the public expenditure in India. The external trade balance, by providing access to foreign savings (in case of trade deficit) increases the possibility of incurring higher public expenditure. But in the Indian context, the trade deficit or the possibility of incurring it, in the light of persistent forex constraint seems to have negatively impacted the public expenditure size. Availability of sufficient amounts of external assistance (that has averaged about 1 percent of GDP throughout the study period) and forex resources have positively influenced public expenditure in India by providing additional leverage for the government to incur higher expenditure, without the need to worry about the repercussions on the external front.

Part of the public expenditure behavior in India at least in the initial years is contained in the theory of economic dirigisme, where the public expenditure was used to promote economic development led by ‘state accumulation’. This manifests in terms of heavy investments in public sector enterprises and in other spheres.

7.4.8 POLITICAL FACTORS

Impact of political determinants on public expenditure, though outside the scope of the present study, is also considered albeit briefly. The political factors did have a predominant role to play in the Indian context. The political masters with the electoral outcomes in mind have preference for those items of expenditure which yield quick results. This directly translates into the preference for the current or revenue expenditure or consumption expenditure. The decline in the single party led government and the emergence of coalition polity seems to have perpetuated this tendency in India too. However the elections do not seem to have had any significant and apparent impact on the size of public expenditure in India. The pressure groups also known as special, interest groups are supposed to have influenced public expenditure decisions, especially in the period prior to nineties. The pressure groups in India, as indicated by Bardhan consisted of farm lobby, industrialist capitalist class and professionals and bureaucrats each trying further their own interests, pulling public expenditure in different directions. Nineties period may have seen weakening of some of these players, as despite a strong resistance, successful pruning of fertilizer and export subsidy has taken place. But the period may have witnessed the emergence
of 'strong media' as a new pressure group significantly influencing the public opinion.

7.5 IMPACT OF PUBLIC EXPENDITURE

Public expenditure affects numerous economic variables in different ways, and, therefore of all the aspects of public expenditure impact analysis is the most widely discussed area both in theory and practice. Public expenditure, its size, composition, financing pattern affect plethora of economic variables. This happens through different transmission mechanisms. Public expenditure may affect variables in positive way or negative and at times both the ways. In a macro sense it affects the output both from demand as well as supply side.

7.5.1 IMPACT OF PUBLIC EXPENDITURE IN INDIA

Numerous empirical investigations have been carried out assessing the incidence of public expenditure in India and elsewhere on numerous macro economic variables like output, poverty, money supply, income distribution etc. Impact of aggregate public expenditure and its components, the possible role of its source of financing are also considered by several studies.

The present study considers impact of public expenditure in India on certain macro economic variables. Based on the results of Granger causality tests and theoretical inputs the short listed variables for analysis of public expenditure impact include GDP, savings and capital formation, money supply and inflation, poverty, labour supply and public debt. The OLS regression analysis shows that the impact of public expenditure on all these variables is significant at 5 percent level, except for the external debt.

7.5.2 PUBLIC EXPENDITURE AND ECONOMIC GROWTH

The direction of causality between public expenditure and GDP is not clear in theory. However, the results of causality tests for India indicate that causality runs from public expenditure to GDP upholding Keynesian proposition and repudiating Wagner's hypothesis. Public expenditure negatively affects GDP by 'crowding out' effect, both 'transactions' and 'portfolio' type. On the positive side public expenditure
by adding to aggregate demand and through 'multiplier' and 'crowding in' effects aids output growth. In the presence of an accommodative monetary policy, the final impact of increase in public expenditure could be even more expansionary. During about half of the study period Indian economy experienced only a modest income growth of 3 to 3.5 percent per annum and this was also a period when public expenditure as percentage of GDP was increasing and reached peak. During this period the share of capital expenditure, widely considered to be more growth promoting, accounted about healthy 30 percent of total expenditure and the revenue surplus in most of this period added to the domestic savings. The limited borrowings resulted in less crowding out. These factors positively contributed to the GDP growth prior to eighties. But the low level equilibrium trap during this period also indicates that public expenditure is just one of the several factors, probably the minor factor influencing GDP growth. Several infrastructural, forex, and policy bottlenecks may have impeded the growth and several exogenous shocks like droughts may have further acted as the dampening factors.

During eighties GDP grew at a higher rate of over 5 percent which however, became unsustainable by early nineties. Increasing profligacy, higher debt and resultant transactions crowding out, declining share of capital expenditure, higher deficit monetization added to the un-sustainability ultimately resulting in crisis situation in 1991. In response to the crisis was the wide ranging Structural Adjustment Programme was initiated of which public expenditure and fiscal deficit reduction has been the major components. The public expenditure moderation, resultant fiscal discipline, lesser deficit monetization resulted in high income growth in the nineties. The policies of economic liberalization like financial liberalization (that created more liquidity and less financial crowding out), inflow of foreign capital etc. complemented the public expenditure moderation efforts. However, the consistent decline in the share of capital expenditure may have negatively affected the growth to some extent in the nineties.
7.5.3 PUBLIC EXPENDITURE, SAVINGS AND CAPITAL FORMATION

Savings and capital formation play a very crucial role in economic growth. Public expenditure by way of influencing savings and capital formulation also affects GDP growth indirectly. Traditional macroeconomic theories suggest that saving is an increasing function of interest rate and income. Public expenditure by positively assisting the income growth contributed to higher savings in India. The higher public expenditure, if debt financed, is likely to put upward pressure on interest rate and the resultant higher interest rate may positively influence savings. The Indian economy, for large part of the study period, even running up to mid nineties, was under the administered interest rate regime and hence public expenditure positively influencing the savings by ‘interest rate route’ has not been a possibility. The contribution of public expenditure to the higher savings (as the regression results indicate), therefore must have come through the income route. The operation of Ricardian Equivalence Theory, where people save more now to pay for higher taxes in future necessitated for debt servicing also contributed to higher savings in India.

Accompanied by higher share of capital expenditure along with higher public and aggregate savings, capital formation in the pre-eighties period improved. In the eighties, more so in the nineties withdrawal of the State is indicated by declining public expenditure-GDP ratio, stable debt-GDP ratio level, lower deficit monetization complemented by policies of economic liberalization, and therefore may have resulted in higher capital formation.

7.5.4 PUBLIC EXPENDITURE, MONEY SUPPLY AND INFLATION

Higher money supply and inflation have been some of the inevitable adverse consequences of excessive public expenditure in developing countries. The public expenditure has positively influenced money supply growth in India. This mostly happened through actual printing of money or through the sale of government bonds and securities to the central bank. The resultant high powered money creation depending upon the value of money multiplier, led to far higher money supply growth. Monetization of deficit provided easy way to finance public expenditure which was particularly high in the eighties when deficit monetization on average
accounted for capital expenditure which however has not been the case in India. The higher monetary creation rather resulted in higher inflation in India.

Public expenditure causes inflation through other routes also. The financial crowding out leads to higher interest rates, and the resultant higher production cost results in higher prices. This however, has not happened in the Indian case. Rather, it is the addition to the aggregate demand with no appropriate supply response that resulted in inflation, (in the short run) in India.

7.5.5 PUBLIC EXPENDITURE AND POVERTY

Public expenditure helps poverty reduction indirectly to an extent as it can stimulate growth and employment. Higher income generation (due to public expenditure) generates higher revenue that is necessary for social security spending which directly affects poverty. In India, for considerable period of time the planners relied on trickle down theory to make a dent on poverty. High allocations for capital expenditure with strong input-output linkages by helping income growth contributed to poverty reduction only for a limited extent. Realizing the futility in making any significant dent on poverty through this route, our planners decided to tackle poverty directly. This involved various poverty alleviation and employment generation programmes that resulted both in creation of assets and incomes for the poor especially in times of distress. However too many such programmes with too thin a spread of resources coupled with leakages reduced the efficiency of such programmes.

The food and fertilizer subsidy were thought to be the part of poverty alleviation strategy. The wide network of PDS, with increasing food subsidy bill over the years provided economic access to food for millions of poor families. But subsidy regime was bereft with some problems like improper targeting and seepages at various levels. But the reduction in food subsidy during nineties may have some serious adverse repercussions, for the poverty alleviation efforts in India. The fertilizer subsidy helped in the adoption of new agricultural technology, by enhancing crop production augmented the incomes of the rural populace. Hence, despite certain
inherent limitations, public expenditure in India did help in poverty reduction efforts both in direct and indirect ways.

7.5.6 PUBLIC EXPENDITURE AND PUBLIC DEBT

Public debt has been a direct consequence of excessive public expenditure in India coupled with the inelasticity of tax revenue and other concurrent developments. Public debt has been increasing steadily since mid seventies. Though it has stabilized now, at about 55 percent of GDP it is very high and has serious implications for debt servicing inter generational equity. The external debt however is a less worrying aspect which is declining since mid 1970s. Therefore, it is the internal debt, both due to its sheer size and several implications for the domestic macro economic parameters that continues to be the headache. Especially with the linking of interest rate on government borrowings to the market rate of interest in the post reform period, the interest has risen further. Thanks to the sufficient liquidity in the system that has not put any undue upward pressure on the level of interest rate. However, the tax-GDP ratio improves and the slide in it is not arrested, the public expenditure will continue to put pressure on the quantum of public debt, more particularly on the size of internal debt.

7.6 PUBLIC EXPENDITURE MANAGEMENT

Larger the size of an activity, greater is the need for its management. With the expansion of government and its overreaching arms into plethora of economic activities, the better public expenditure management (PEM) too has become inoperative. Though this concept is somewhat new to the developing world, India had some PEM system in place from the beginning itself. In the recent years, especially, in the aftermath of economic reforms, it has assumed added significance. At the same time, the difference between the ‘expenditure policy’ and ‘expenditure management’ has substantially, narrowed down, and now the PEM along with the former encompasses several other aspects too. Further, it is to be noted that there is no one size fit all PEM (ADB, 1999) as some seem to believe and also that PEM is no panacea for the mismanagement of macro-economy and poor budget outcomes (JBIC, 2000). The broad objectives of PEM apart from fiscal discipline include macro
economic stability, transparency, accountability, financial discipline, efficiency gains etc.

7.6.1 PUBLIC EXPENDITURE MANAGEMENT IN INDIA BEFORE NINETIES

Budget at the centre of PEM, India from beginning itself, has put in place in well organized system for budget formulation, execution, monitoring and evaluation of effectiveness of budgetary expenditures (Rao and Rajgopalan, 1990). At the stage of preparation, public expenditure decision making in India involves wide range of institutional actors from legislative and executive branches of the Government (Rao, 1990) and actors from outside government as well. etc. The budget is laid before the Parliament and no expenditure is incurred without Parliament’s nod. The process, however, provides enough flexibility to meet some unforeseen expenditure and to incur certain items of expenditure. Implementation of the expenditure proposals is carried out by the respective administrative ministries and ‘Programme Implementation Wing’ of Ministry of Statistics and Programme Implementation that monitors the implementation of various programmes.

Each ministry or group of ministries has Financial Adviser (FA) whose approval is necessary for all the budgetary releases. The periodic reports of the FAs are sent to the CAG. The ‘Monitoring and Information Division’ monitors project implementation especially under the plan heads and now there exists a separate ministry ‘Ministry of Programme Implementation’ to monitor project performance. The Indian Constitution also provides for the setting up of Parliamentary Committees to exercise control over the public expenditure and to ensure economic spending of the planned amounts. Each ministry has an internal audit wing and at the apex of the auditing is the Comptroller and Audit General (CAG) of India. Apart from the institutional arrangements, several policy measures in India, especially in the 1980s like Long Term Fiscal Policy, Mid-term appraisal of VII Plan too, underlined the need for better PEM and control.

Despite elaborate arrangements for public expenditure control and management before 1990, quality and efficiency of public expenditure suffered and, fiscal prudence took a severe beating. The constitutionally ordained framework
worked fairly well, not the ones outside it, which just did not take off, despite periodic pronouncement of several measures. Much rigidity crept in, medium term perspective was lacking and therefore, fiscal situation worsened. List of innovations for public expenditure control and management was impressive, but actual usage did not result in any significant improvement (Rangachari, 2002). Populist measures thrived, the pressure groups continued to exert their influence expenditure spiral'. In the process of budget making, forecasting errors resulted in fiscal marksmanship and adhocism. At the implementation level, only plan programmes were monitored, and not the non-plan expenditure items. The audit system became only accounts-oriented with no control over objectives, tasks and outcomes. In toto, the PEM per se existed, but the focus on efficiency, effectiveness and outcomes of public expenditure was lacking.

7.6.2 PUBLIC EXPENDITURE MANAGEMENT REFORMS IN NINETIES

For most part of the nineties, fiscal reform was synonymous with tax reform. Despite mention in every budget, no major PEM reform measure with medium or long term vision was announced. Expenditure reduction measures remained sporadic and arbitrary in nature (Premchand and Chattopadhyay, 2002). (Despite this public expenditure to GDP ratio has continued to decline in the 1990s.) It was only the late­nineties that witnessed the initiation of some major expenditure reform steps like the setting up of ‘Expenditure Reforms Commission (ERC) and tabling of Fiscal Responsibility and Budget Management Bill which is an Act now. The ERC set up in the year 2000 in its several reports made several useful suggestions with regard to rationalization of food and fertilizer subsidies and measures to optimize staff strength. Subsequently the Commission has come out with several reports with clear cut guidelines/suggestions for expenditure rationalization for each ministry/department.

One of the significant fiscal measures to be adopted in the post-independent India has been the enactment of Fiscal Responsibility and Budget Management Act (2003). A ‘legal teeth’ became ‘inevitable’ in the light of difficulties in achieving the fiscal targets and missing the figures more often than not. By this India became one of the countries to take a legal recourse, taking cue from such experiments mostly in the developed world. It is stated that Indian legislation largely resembles that of the New
Zealand Act (Venkataraman and Rangachari, 2002). Many countries following the enactment of legislations could successfully achieve fiscal discipline and turn their long standing budget deficits into surpluses. Through the legislation, India too hopes to set the much needed and long troubled ‘fiscal house’ in order.

Indian fiscal situation evinced great amount of interest among international institutions. According to World Bank assessment of PEM, India fares ‘average’ among developing countries on governance, gets fairly good ranking with respect to budgetary process, but tanks much lower in terms of management of public finance.

7.6.3 CRITIQUE OF NINETIES PEM POLICIES AND SUGGESTIONS

Several policy reforms initiated during 1990s were adhoc in nature, basically being knee-jerk reactions to the prevalent crisis. Therefore, fiscal discipline even today still remains an area requiring attention. Fiscal strategy for the medium term is the need of the hour. It may include steps like muti-year budgeting. The medium term perspective should go much beyond setting up of physical targets and cover the aspects of efficiency, economy and effectiveness of PEM. Therefore, the approach should be holistic in nature.

The neglect of fiscal discipline in India often ignored its possible repercussions on the macro-economic stability which is an essential pre-requisite for sustained economic growth. Hence the formulation of PEM policy needs to recognize its linkages with the rest of the economy and ought to be consistent with the overall macro-economic policy framework.

Often the budgets contain too many programmes with overlapping objectives, fragmented and too thin allocations that greatly reduce the efficiency of such programmes. Therefore, it makes a lot of sense to group these into few broad categories which again need to be periodically reviewed. Another proposal worth considering is the ‘revenue budgeting’ before setting the expenditure budgeting, so that expenditure prioritization and thereby expenditure efficiency can be achieved. In this context the introduction of Zero Based Budgeting must be carried forward by strictly adhering to the set targets and time frame. Once a medium term policy is in place, a high powered reform management body to oversee its timely implementation
and periodic review may be set up. The ERC may be assigned this job in the Indian context.

Transparency and Accountability are integral to the effective PEM at all levels, be it policy formulation, implementation and review. In addition to free and easier availability of information, timeliness and regular reporting are also critical. Clear accountability for the discrepancies at any stage is a must and more effective system for fixing accountability must be put in place. This, along with the system of incentives and disincentives would do lot of good to the efficiency aspect. The ‘IMF Code of Good Practices of Fiscal Transparency’ gives detailed list of steps to be taken in this connection that is worthy of consideration for implementation.

7.6.4 PUBLIC EXPENDITURE CONTROL AND METHODS

Public expenditure control is an important aspect of PEM. In fact in the initial stages, especially in the advent of deficits of higher order, PEM may become synonymous with public expenditure control. Several methods are suggested for the curtailment of public expenditure that range from providing a legal framework to the disinvestment/privatization of PSEs.

The financial approach to the PEC may not be sufficient. In addition, policy reviews may be necessary with respect to subsidies, defense, staff strength, etc. In order to reduce the pressure on government expenditure, measures like public-private partnership, partial disinvestment or complete privatization of PSEs, contracting out of certain government services to private agencies and several other innovative methods may have to be explored.

7.7 POLICY IMPLICATIONS

The present study, covering the public expenditure in India in the last four decades comes out with several important findings. The study brought out the paucity of studies at all India level covering the period of nineties, especially involving the analysis of determinants, impact and management aspects of public expenditure. The changing structure of pubic expenditure points out a welcome trend at a macro level as reflected in the declining public expenditure-GDP ratio clearly indicating moderation in the level of public expenditure. However this has been achieved at the
cost of capital expenditure. The study also brings out the point that several items of revenue expenditure are declining for the good, but few others throw up disquieting trends.

The analysis of the determinants of public expenditure showed that economic factors do have role to play in public expenditure decision making. Savings played a role earlier but in the nineties, there seems to have been detachment in the dependency between savings and public expenditure. But the budgetary expectations have continued to exert influence. Tax revenue is the other factor influencing the magnitude of the public expenditure, and other budgetary factors like tolerance of higher deficits and total transfer to the states have also been important. The demographic factors expectedly have been prominent. However with the opening up of the economy, as the study shows the external factors especially the extent of outward orientation and magnitude of trade balances too have come to influence the public expenditure decision making.

The impact analysis brings home the point that public expenditure through its possible influence on the savings, capital formation, public debt, is a factor influencing the economic growth and thereby has implications for the poverty reduction efforts. Therefore, better public expenditure management becomes imperative in order to maximize the benefits from the public expenditure. The expenditure management therefore needs to adopt holistic approach with a clear medium term perspective with emphasis on transparency and accountability in order to achieve the desired objectives. In this context, the belated efforts as contained in the Fiscal Responsibility Act go a long way in carrying the expenditure reforms to a logical end. The findings from the present study hold several policy implications—which are briefly summarized in the following paragraphs.

While the public expenditure compression as part of expenditure reforms that is in progress since about mid eighties is necessary, the need for quality of correction should not be lost sight of. Specifically the fact that the axe of public expenditure correction has fallen on the capital expenditure, holds negative repercussions for the growth prospects of the economy. Therefore, there is a great need for increased
allocation for the capital expenditure and ensure quality to the correction process. The revenue expenditure needs to make a larger contribution to the adjustment process. However, some of the predominant items of revenue expenditure like interest, pension payments, salaries and allowances etc are committed in nature and cannot be pruned immediately. This requires a medium term strategy with clear quantitative targets for each of the major expenditure items be it defence, subsidies or others. While tackling the defence expenditure the national security considerations be kept in mind. Similarly, in dealing with subsidy—food and fertilizer, the issues of food security and fight against poverty and hunger should be foremost in the mind. More than the explicit subsides, which have already been squeezed to considerable extent, the focus should shift to the implicit subsidies. All possible efforts are to be made to rein in the growth of interest payments. The defence expenditure may be maintained at the present level, or may be marginally scaled down. This however depends on the recurrent security atmosphere.

Pension bill that is bound to emerge as a major irritant needs to be contained. While the centre cannot do much about the current pension payment obligations, the future growth, at least, may be tackled. The present obligations if become too heavy, centre may consider its payment, at least in part, in non-cash form (like NSC, IVP, long term govt. bonds etc). Among the capital expenditure, while all efforts be made in restore if to at least 50 percentage of the mid-eighties level in the next 3-4 years. The capital outlay part of capital expenditure, which has drastically gone down requires huge resurrection.

The analysis of the determinants of public expenditure in India reveals the important role played by several economic factors. The quantum of savings provided enough cushion for the growth of public expenditure. As the GDS has plateaued in the nineties, it needs to be pepped up. While the focus on household and corporate savings is necessary, it is the public savings that have turned negative which need to contribute to the GDS. This requires, turning revenue deficit into surplus, huge improvements in the usage of funds i.e., productivity and efficiency in resource use particularly in the govt. sector and larger contributions from the PSEs which in turn calls for massive public sector reforms. A budgetary expectation is another important
determinant of public expenditure in India. The budget estimates of the previous years influence the quantum of public expenditure for the present year. This therefore calls for huge improvements in the estimation and forecasting techniques in order to avoid the instances of fiscal marksmanship that are galore in the present Indian context. This phenomenon should be tackled with all seriousness. Tax revenue is another important determinant of public expenditure in India. The declining tax-GDP ratio in the nineties, forced the public expenditure reduction to some extent, otherwise it would have put undue pressure on the other sources of financing public expenditure.

However, as the public expenditure -GDP ratio is moving up at the fag end of the study period, the tax-GDP ratio needs improvement now. Otherwise it may put upward pressure on the extent of public borrowings and interest payment obligations which are not good for the economic growth. The easy resort to the deficits (and borrowings) has been a factor for public expenditure growth in India. This however is not good from view point of macroeconomic and fiscal health of the country. The FRBMA which aims to tackle the revenue deficit and fiscal deficit should be carried to the logical end. The decline in the total transfers to states enabled the public expenditure in the nineties. But once the regional coalition partners take note this source of expenditure cannot be relied upon to achieve public expenditure containment further. As the demographic parameters have been exerting positive influence on public expenditure in India all through, any let up in the population control might change the tune of the song and this stresses the need for population control especially in the 'Hindi Heartland' of north India.

Increasing integration of the Indian economy with the global economy, has imparted policy discipline with respect to public expenditure. Increasing outward orientation of the economy necessitated the expenditure compression for various reasons. As India becomes an active member in the global economic village, its soothing effect on public expenditure front will continued to be felt. Higher trade deficit provided access to foreign savings. This dose not however means a free play for the unbridled growth of trade deficit that should be guided by altogether a different set of factors economic considerations.
Public expenditure has significant influence on the economy. The Indian experience in the eighties suggested that the fiscal profligacy makes economic growth unsustainable. This therefore calls for continued moderation of the public expenditure in India so that the resultant fiscal discipline and lesser monetisation lead to higher income growth. To complement the pace of economic growth, the share of capital expenditure, capital outlay in particular, must increase. Public expenditure also affects both the GDP growth and the level of interest rates. This makes an obvious case for the public expenditure discipline and significant changes in the financing pattern of the public expenditure (especially away from the debt financing). The consideration of money supply and inflation further stress this point. As the public expenditure in India is found to have played significant role in poverty reduction a careful and well though about expenditure prioritization is essential. That makes an obvious case for better public expenditure management (PEM).

Despite having some arrangement in place, PEM system in India is far from complete, though in few aspects it fairs quite well. PEM is an evolving concept and hence has to keep track of changing developments. In the changed scenario PEM system needs to have medium term perspective (FRBMA goes a long way in this direction). The audit system needs to re-orient itself and become outcome- oriented, not just accounts- oriented. While flexibility is the hallmark of a modern PEM, adhocism should be avoided. Policies should adopt a holistic approach with focus on economy, efficiency and effectiveness. Transparency and accountability should become an integral part of the system. Such a system is an essential pre-requisite for the sustained economic growth.