# CHAPTER - I

## INTRODUCTION

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PUBLIC EXPENDITURE

Governments all over the world assume certain vital responsibilities for the people whom they rule over. The obligations of the government arise from ideological or political reasons and from those dictated by the mandates of law. The fortunes or miseries of the people are largely correlated with the nature and purpose of the responsibilities that the government assumes. The responsibilities of the government are sought to be discharged through various governmental activities, the performance of which invariably entails public expenditure.

The term 'public expenditure' is a compound of the two words 'public' and 'expenditure' of which the public represents government and expenditure signifies expenses of money. According to the two words, public expenditure embraces the pecuniary resources of a government - central, state and local. And the science of public expenditure studies the principles underlying the acquisition and use of such resources by the government owning it.

The principles of public expenditure are closely associated with the functions of the state and are correlated with the aims and ideals of the state which it attempts to achieve.\(^1\) The method of spending resources and the activities to be performed by the state are thus dependent upon the needs of the state\(^2\), which are the given objectives for the public expenditure. The scope of public expenditure, therefore, enfold within itself the money spending activities of the government.

The money spending activities of government need to be demarcated from those of private individuals. For, the state incurs those expenditure which the people in their individual capacity either would not or cannot incur. The quantum, purpose, cost-benefit incidence and gestation period of public expenditure programmes are the major points of demarcation. Thus, in clear contrast to private expenditure, public expenditure is heavy and citizen oriented, the benefits derived from it expand over a long period.
Having kept the orbit of demarcation in mind, public expenditure can be defined as the expenditure incurred by the government for the maintenance of the government, internal and external security and for the promotion of socio-economic welfare of the people. H. C Adams\(^3\) gives a holistic view of the functions that the public expenditure has to perform. According to him, public expenditure performs: (a). Protective functions - Military, Police, Court and Protection against Social Diseases (b). Commercial functions - Setting of Commercial Establishments under state control and (c). Development functions - Education, Public Recreation, Maintaining Equitable conditions for the Execution of the public business, public investigation and infrastructure development like public works, irrigation, forestry, etc. Musgraves\(^4\), rather seemed to have correlated public expenditure with the economic or fiscal functions of the state. Following them, public expenditure embraces three economic or fiscal functions of the state: allocative, distributive and stabilising functions.

Public expenditure includes capital as well as revenue expenditure and reflects the behaviour of the government in relation to the pattern of such expenditure. Public expenditure is also called government expenditure or state expenditure. Being a study of the money spending activities of the state or government, it analyses how finances both in cash and kind are spent or should be spent to enable the state to perform its activities according to its avowed goal\(^5\).

The decisions about government expenditure are the outcomes of a political process in which the views of political leaders and other policy makers are influenced\(^6\). But the actual expenditure in any given year is largely determined by previous legislations and historical trends of government actions. Public expenditure, thus, reflects the decision of the parliament/legislature and executive bodies as to the field and scope of public activities and expenses.
Public Finance, Fiscal Policy and Public Expenditure

Public finance is essentially an investigation into the nature and principles underlying the revenue expenditure process of the government. It deals with expenditure and income of public authorities or the state and their mutual relation as also with the financial administration and control. A more comprehensive view on public finance is held by C. S. Shoup\(^7\), stated “the discipline of public finance describes and analyses government services, subsidies and welfare payments and the methods by which the expenditure to these ends are covered through taxation, borrowings, foreign aid and the creation of new money”.

The definition spells out the possible divisions of public finance such as subsidies, welfare payments, expenditure, revenue, debt and printing of currency. In fact it, too, seems to have centered round taxation and public expenditure.

Musgrave\(^8\), on the other hand, holds a different view. He rather focuses on fiscal policy, with direct emphasis shifted from the revenue expenditure process to fiscal policy objectives. According to him, “public finance explores the fiscal policy of the state and how they can be best used to meet the goals of public policy”. The goals of public policy or fiscal policy are economic growth, stability, full employment, etc. It is, however, worth noting that fiscal policies are also dominated by the revenue expenditure process. For, A. G. Bucher\(^9\) has rightly observed that, “fiscal policy is a deliberate adjustment in expenditure and revenue to further the aims of national economic policy”. The Fiscal Responsibility Bill of Government of India\(^10\) also expresses a similar view, “in a medium term framework, fiscal policy shall include an assessment of sustainability relating to the balance between revenue expenditure and revenue receipts and borrowings for generating productive capital assets”. Fiscal policy, thus, aims at overall fiscal discipline and economic stability through the revenue expenditure process of the state.
In contemporary economic literature, however, the word ‘fiscal science’ or ‘fiscal policy’ is seemed to have gained more currency than the word ‘public finance’, especially when used in the context of the fisc i.e., public treasury and public policy. Accordingly the words fiscal crisis, fiscal management, fiscal discipline and fiscal consolidation are gathering momentum. Notwithstanding this shift in emphasis, the above discussions rightly lead to the conclusion that the revenue expenditure process still remains the focal point in public finance and fiscal policy. And public expenditure forms an integral branch of public finance or fiscal policy, constituting the money spending activities of the government.

The Growth of Public Expenditure and its Implications

Inspite of the fact that both public revenue and public expenditure are dominant components of public finance or fiscal policy, ‘economic theorists of the 18th and 19th century were fascinated more by problems of raising revenues by taxation than by spending of the public money’\textsuperscript{11} They paid lesser attention to public expenditure and that it received far less economic analysis\textsuperscript{12}

One of the major reasons for the neglect of public expenditure was the influence of the philosophy of free market economy, which proclaimed automatic mechanism of the market forces and limited the activities of the government to police, justice and arms. They objected public expenditure on the presumption that it was a waste and an oppressive imposition upon the public. J. S. Mill\textsuperscript{13} was the more ardent of the supporters of this philosophy. He held that, “the business of life is better performed when those who have an immediate interest in it are left to take their own cost, uncontrolled either by mandate of law or the meddling of any public functionary”.

Yet another factor responsible for the neglect was, ‘the feeling that the level and structure of expenditure were determined politically and were thus beyond the
economist's proper orbit of study. Thus till the dawn of 20th century, the topic of public expenditure remained neglected both by the academia and economists.

But certain remarkable events of the 20th century such as the global depression, the world wars, the emergence of independent nations, etc. have brought about radical changes in the concept of the state and its activities. Many countries became welfare democracies wherein the state was to provide from what is called 'cradle to grave' or 'womb to tomb'. In course of time, many governments seemed to have transformed from, following Dilulio, being direct providers to financiers, arrangers and overseers. This new role of government, propelled its activities in all directions requiring large sums of public outlay. Being an erstwhile colonial state, the situation in India was also not different; nor the situation in Kerala could not be different too. The governments, here, had to work as an entrepreneur to promoting economic growth. It had to take creative steps in bringing up the deteriorating economy by investing in social and overhead capitals.

All these developmental challenges took the level of the state activities to towering heights. As a result public expenditure has increased in size and complexity. These complexities assumed new dimensions and placed the hither to 'neglected topic of public expenditure at the heart of public finance. The subject of public expenditure has thus begun to attract the attention of not only economists but also political and social scientists. Today public expenditure policies impact the overall fiscal policy of a country. It becomes the major element in the process of fiscal consolidation and aggregate fiscal discipline. Sooner, scientific management of public expenditure has begun to be recognised as a vital development imperative and consequently the topic of Public Expenditure Management has emerged as a challenging proposition for economists and public administrators.
PUBLIC EXPENDITURE MANAGEMENT (PEM)

The profuse expansion in the level of activities of governments has led to conspicuous growth of public expenditure, to seriously disturb the revenue expenditure equilibrium. The growth in expenditure of governments more than proportionate to the growth in revenue has resulted in the accumulation of huge revenue / fiscal deficits which created a debt-deficit spiral leading to a consequent fiscal crisis. This growing fiscal crisis is the central focus in Public Expenditure Management (PEM), for it has made expenditure management in government not only a herculean task but also an urgent necessity. PEM has, therefore, come to address the growing complexities and multiple dimensions of expenditure, taken along its contents and contours of control and management.

Public Expenditure Management is a comprehensive term that signifies appropriate and transparent allocation of public expenditure among competing priorities with a view to producing intended results at least cost. It lays out plan of actions to eliminate wastages and leakages and ensures efficiency, economy and frugality in the use of budgetary resources. It aims at ‘redirection of government spending for better development outcomes; improvement in service delivery; empowerment of the poor in overseeing government actions and expenditure ’. These actions tend to pave way for ‘strategic prioritisation and rationalisation of expenditure’ based on efficiency, quality and effectiveness. They are the key elements in a PEM process, which purports to effect suitable changes in the mix and composition of various spending streams so as to bridge the revenue capital gap and create more productive capital expenditure.

Control of public money becomes yet another area of importance in PEM process. It sets focus on control of public money through the process of planning, budgeting, accounting and evaluation. Accordingly it embraces the whole spectrum of expenditure controls involving policy controls transactional controls, regulatory controls and efficiency controls - revolving around the political, economic, organisational and
budgetary factors. Budget formulations and budget executions thus become the core factors in public expenditure control mechanism. For, ‘in public expenditure management reforms, the basics include hardening the budget constraints as part of a more top down approach to budget formulations and strengthening the discipline with which input oriented line-item budgeting is enforced’.

PEM also plays a vital role in restoring the credibility of government spending agencies by incorporating the key aspects of financial disclosure and fiscal transparency. While financial disclosure envisages public availability of information on the past, current and projected fiscal activity of government, transparency makes decision making process clear and unambiguous. As noted in the IMF survey, ‘fiscal transparency is a key aspect of good governance, sustained economic stability and high quality growth’.

Public expenditure management does not mean mere expenditure compressions or cuts or complete abandonment of expenditure streams as such. Though all these programmes may form part of a PEM process, the central focus in PEM is on improving quality, efficiency and effectiveness of public expenditure. Good public expenditure management, therefore, requires attention to the level of aggregate spending, allocation of public funds and actual delivery. Accordingly reprioritisation and rationalisation of expenditure become the key in public expenditure management, for they are instrumental in creating more productive capital expenditure. Ultimately, public expenditure management aims at making effective, responsible and accountable government on the road to fiscal consolidation and aggregate fiscal discipline.

The fiscal situation is getting out of control or turning out to be a crisis for many a governments including governments in India. As Herzlinger noted, “unlike publicly traded corporations, the performance of non-profits and governments is shrouded behind a veil of secrecy that is lifted only when blatant disasters occur”. Though time seems
to have crossed the limits, the government should come out of the veil of secrecy and act quickly upon the crisis before any blatant disasters occur. The crisis is to be conceived as a battle and should be fought out valiantly, by using public expenditure management as the main weapon and that weapon is the subject matter of the present study.

**IMPORTANCE OF THE STUDY**

A multiplicity of causes such as colonial imperialism, freedom struggle, advent of democracy, adoption of five year plans, urbanisation and pressure of globalisation have greatly contributed to the rapid increase in the level of activities of the Government of Kerala along with other states in India. These emerging issues brought about a drastic shift in emphasis of government philosophy, a shift from a traditional police state to a modern welfare state wherein the role of the government has been enhanced to that of a provider from a protector. This shift in emphasis created new developmental challenges in the state which set the role of the public sector at commanding heights, requiring heavy doses of public expenditure. It has eventually led to the modern practice of ‘the size of expenditure determining the size of revenue’ and resulted in alarming growth in expenditure of the government more than proportionate to the growth in revenue, thereby disturbing the revenue expenditure equilibrium. This left huge revenue / fiscal deficits year after year. To finance these mounting deficits, the government resorted to increased domestic as well as external borrowings at exorbitant rates. The borrowings in turn gave rise to more committed charges in the form of debt servicing and interest payments, leaving little for productive capital expenditure.

These facts together with the propensity of expenditure to grow have led to an economic and fiscal crisis in Kerala since the late 1980s, which needs urgently to be overcome through the process of fiscal restructuring and fiscal consolidation of which the main elements are public expenditure rationalisation and Public Expenditure Management (PEM). This growing fiscal crisis is the central focus of
Public expenditure management. Public expenditure management is also a vital imperative in equipping the government to live up to the challenges of the new world order; for going global, the government should also be cost efficient, output oriented and commercial in outlook.

In Kerala, however, sufficient attention is not given to public expenditure as the prime contributory factor for huge fiscal deficits and sustainable deficit being a function of the quality of expenditure in terms of necessity, efficiency and effectiveness. While the government has cut down on investment, it has not cut down on spending. Kerala’s fiscal imbalances, which mainly lie at the revenue side of the account consisting of revenue receipts and revenue expenditure, have started worsening since the late 1980s and turned into a real crisis from the 1990s in the form of frequent overdrafts and treasury bans.

The present study, therefore, seeks to address the management of the revenue expenditure of Government of Kerala, as the state’s fiscal crisis lies at the revenue side of the account of which the revenue expenditure is the prime contributory factor. It investigates into the multiple dimensions of revenue expenditure along the contents and contours of control and management, reaching its micro foundations. The study seeks to suggest a micro system of public expenditure management for Government of Kerala.

Moreover, Public Expenditure, the dominant component in the study of Government Finance, is welcomed by the academia, the economists, planners, administrators and the general public. The research conducted in India on such an important area - Public Expenditure Management - is meagre. The subject has suffered serious neglects in Kerala as well; only a few attempts have been made in the state and that they cover only certain aspects from a macro perspective.
The piece of research work entitled "Management of Public Expenditure; A Study with Special Reference to Government of Kerala" attempts to fill the gap. It is an optimistic belief that the findings of the study and the suggestions made thereon will have practical utility for government of Kerala in managing its Revenue Expenditure enroute to a proper system of expenditure management.

OBJECTIVES OF THE STUDY

1. To study the trends of various components of revenue expenditure such as sectors, sub-sectors, major / sub-major heads, plan, non-plan, voted and charged.

2. To analyse each item (major / sub-major headwise) of revenue expenditure in comparison with Total Revenue Receipts (TRR) and Total Revenue Expenditure (TRE).

3. To identify and appropriately classify each item (headwise) of revenue expenditure under different risk classes.

4. To suggest Public Expenditure Management strategy for each item of risk classified revenue expenditure based on analysis and findings.

HYPOTHESES OF THE STUDY

1. Sector wise comparison of revenue expenditure in terms of rate of increase and as a share of TRR and TRE indicates that out of the four sectors (consisting of eighty four major heads) General services will rank first followed by Economic Services, Social Services and Grants-in Aid & Contributions

2. Headwise comparison in terms of Risk Expenditures and High Risk Expenditures indicate that most of the Risk and High Risk Expenditures will fall in the General Services Sector
METHODOLOGY OF THE STUDY

1. An analysis of eighty four major/sub-major heads of revenue expenditure of Government of Kerala was made after completing the relevant preliminary works such as discussions with experts, reviewing literature on public expenditure, theories of public expenditure and studies and research works conducted within and outside India as well as in Kerala. This was done with a view to identifying the major items of revenue expenditure that contribute to the fiscal drain of Kerala both in terms of rate of increase and size.

2. The data for the present study is compiled from the yearly reports of the Finance Accounts of government of Kerala for the period 1990-91 to 2001-02. This period is selected for detailed analysis because an examination of data reveals that the state’s fiscal crisis got really intensified since the late 1980s; further this period would cover two plan periods in the post liberalisation era.

3. For identifying the major heads of revenue expenditure that contribute to the fiscal drain of the state, the expenditure, for the purpose of management, are grouped into as either Low Risk Expenditures (LREs) or Moderate Risk Expenditures (MREs) or Risk Expenditures (REs) or High Risk Expenditures (HREs), on the basis of four different categories of analysis as follows:

a. Category I & II - Analysis of the percentage increase in the expenditure concerned with the corresponding increase in TRR and in TRE. Out of the twelve years compared, if the number of years in which the percentage increase in the expenditure concerned exceeds TRR and / or TRE, falls (i) in the range of 0-2 years, the expenditure is termed as LRE (ii) in the range of 3-5 years, the expenditure is termed as MRE (iii) in the range of 6-8 years, the expenditure is termed as RE and (iv) in the range of 9-11 years it is termed as HRE. (Appropriate score values are then assigned: LRE, 1; MRE, 2; RE, 3; HRE, 4)
b. *Category III & IV* - Analysis of the average share of the expenditure concerned in comparison with the average TRR and TRE for the twelve year period. If the average share of the concerned expenditure in the average TRR and/or TRE is (i) less than one percent, the expenditure is termed as LRE (ii) equal to or greater than one percent but less than four percent, it is termed as MRE (iii) equal to or greater than four percent but less than eight percent, it is termed as RE and (iv) equal to or greater than eight percent in it is termed as HRE. (Appropriate score values are then assigned: LRE, 1; MRE, 2; RE, 3; HRE, 4)

4. The scores for under the four categories of analysis (LRE, 1; MRE, 2; RE, 3; HRE, 4) assigned initially are totalled subsequently for combined analysis which finally defines the risk class of an expenditure in the manner stated thus: (i). If the combined score of an expenditure according to these four categories of analysis is equal to four (4) it is classified as Low Risk Expenditure (LRE) (ii). If the combined total score lies between five and eight (5-8), it is classified as Moderate Risk Expenditure (MRE) (iii) If the combined total score lies between nine and twelve (9-12), it is classified as Risk Expenditure (RE) and (iv) If the combined total score lies between thirteen and sixteen (13-16), it is classified as High Risk Expenditure (HRE).

5. Simple Statistical tools like percentages, averages and ratios were used to analyse, interpret and classify the revenue expenditure into various risk classes with a view to suggesting a system of expenditure management for each such risk classified revenue expenditure.
SCENE OF THE STUDY

The study has been designed to address the problem of management of Public Expenditure of Government of Kerala, undertaken within the framework of the accounting classification of expenditure as brought out in the yearly reports of the Finance Accounts of the state. Due to the voluminous classifications in the Finance Accounts, the study has been confined to identify the revenue expenditure that contribute to the fiscal drain of the state upto major/sub-major heads level; which seem adequate and relevant to realise the objectives of the study.

The study is proposed to cover a twelve year period from 1990-91 to 2001-02. The researcher would be justified in selecting the period, for not only does it cover the immediately succeeding years of the crisis (late 1980s) but also two plan periods in the post liberalisation era. The categorisation of the eighty four major / sub-major heads of expenditure into various risk classes is done using simple statistical tools like ratios, percentages and averages whose validity will govern the validity and generalisibility of the results obtained. Since the study seeks to suggest a micro management system for the various risk classified expenditure, broader macro variables such as state domestic product, population, per capita income, etc, has not been covered by the study.

LIMITATIONS OF THE STUDY

Despite the fact that all the usual precautions were taken to obtain very reliable and authentic results, the researcher would like to point out some unavoidable limitations that have crept into the study:

1. Since the data for the study are compiled from the yearly reports of the Finance Accounts of Government of Kerala, the possibility of its carrying the inherent limitations of the historical cash based accounting system cannot altogether be
ruled out. However, the investigator feels that the data collected from the Finance Accounts of the state would be more accurate and authentic than the data supplied by any other agency.

2. In identifying the major contributors to the fiscal drain of the state only revenue expenditures were analysed by excluding the capital components of expenditure. The investigator firmly believe that the preclusion of capital items will not defeat the purpose of the study for capital expenditure accounts for only a negligible share (6% on an average) in the total expenditure.

3. Inspite of the investigators sincere efforts to ensure the arithmetical accuracy of the mass of data analysed, the possibility of discrepancies creeping in cannot be altogether ignored. The investigator however hopes that these minor discrepancies, if happen to enter, would not have any impact on the results obtained.

4. Since the study strictly falls within the framework of the Finance Accounts classification of expenditure, object wise classification such as salaries, wage bills, etc could not be seperately brought under analysis. However, they are shown merged with the different eighty four heads analysed.

The above limitations, the researcher would like to point out, are not in nature so serious as to vitiate the findings. Most of them are also beyond the purview of the scope for the study.
CHAPTERISATION

The research report is presented in five chapters. They are:

Chapter I - Introduction - Discussions about Public Expenditure, Public Expenditure Management and Importance, Objectives, Methodology and Scope and Limitations of the Study.

Chapter II - Literature Review - Presents a review of literature, Published and Unpublished Research Works on Public Expenditure and tries to suggest the system of Public Expenditure Management for Kerala.

Chapter III - Conceptual Framework - Shows light on how the study is made possible and about the methods and procedures of analysis applied.

Chapter IV - Analysis and Findings - Explains the various stages of analysis done such as sectoral, sub-sectoral, headwise and the management of revenue expenditure.

Chapter V - Conclusions and Suggestions - Gives a backward looking of the entire study and important conclusions and suggestions for improving the management of revenue expenditure by the Government of Kerala.
References


