



## Economical study of an analytical review of Indian Government expenditure from the 1990s onward

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### Abstract

This paper examines the expenditure of the Indian government from the 1990s to the present, emphasizing its crucial connection to economic growth, particularly through heightened investment in education and social sectors. During this time, significant structural changes occurred, such as the liberalization in 1991, which affected spending trends and boosted both public and private investments. The analysis also highlights enhancements in the quality of public expenditure and a reorientation of priorities towards capital investment and fiscal discipline, while recognizing the challenges related to the effectiveness of spending in the social sector and also an analytical Review of Indian Government Expenditure from the 1990s to the present.

**Keywords:** Economics, economical study, government expenditure, economic growth, expenditure patterns

### Introduction

Every individual seeks happiness, and the pursuit of perfect, boundless happiness is the ultimate aim of all societies. The entire field of Economics centers around the concept of welfare, which is synonymous with collective happiness. A society that is stable and content requires a well-functioning state or, more specifically, effective governance. Without a stable government, humanity is destined to endure suffering or even face extinction. Numerous historical examples support this assertion. The questions surrounding the nature and function of the state, as well as the degree of its intervention in economic activities, are not straightforward to resolve. This complexity arises from differing perceptions of the state and its declared objectives. When Adam Smith championed a minimal role for the state in his renowned work 'An Inquiry into the Nature and Causes of the Wealth of Nations' (1776), it was clear that his vision of the state was not one focused on welfare; in contrast, most contemporary states prioritize welfare with diverse objectives. Examining the government's role in enhancing human welfare continues to be a compelling area of research for scholars and development policy analysts. In the 21st century, most nations operate as mixed economies, and the government's involvement in economic activities, along with its ability to significantly influence various aspects of society, is steadily growing. The world has progressed beyond the contentious debate of Capitalism versus Communism. Therefore, it is only natural that the field of Public Economics, also known as Applied Welfare Economics, is becoming increasingly significant in modern economic theory. Raj Chetty, an economist from Harvard, observed that Public Economics often serves as a culmination point for many other sub-disciplines within economic science due to its practical and applicable nature.

While the State does not hold absolute power over policy matters, the formulation of economic policy continues to be its primary responsibility. Economic policy is one of the many types of policies that the government must develop and execute effectively to maximize societal welfare. Public Policy encompasses the actions the government decides to

take or refrain from, and it is typically evaluated based on its consistency and effectiveness.

### Objectives of the study

1. To evaluate the trends and patterns of expenditure by Union and State Governments during the post-liberalization era.
2. To analyze the trends, patterns, and composition of Union and State government spending in the Agriculture and allied sectors.
3. To investigate the trends, patterns, and composition of Union and State government expenditure in the Social sector.
4. To explore the correlation between Public expenditure and Economic growth in India.
5. To assess the influence of Public expenditure in the Agriculture sector on Agricultural output.
6. To discuss the effects of Human Priority components in Health and Education on Gross Domestic Product.

### Hypotheses of the study are outlined as follows

1. A positive correlation exists between public expenditure and gross domestic product during the post-liberalization era.
2. The investment in the agricultural sector by both the Union and state governments has led to an increase in output within this sector throughout the study period.
3. Public spending on education and health positively impacts economic growth.

### Research methodology

To examine the aforementioned objectives and to evaluate the hypotheses, this study employs the data and methodology outlined in the subsequent sections. Data pertaining to the social sector expenditure of Union Governments has been sourced from Indian Public Finance Statistics. The most recent issue of IPFS available is the report for 2017-18. In this report, actual estimates are provided only up to the fiscal year 2015-16. Data from 2015-16 to 2021-22 has been gathered from Volume I of the Expenditure Profile of Union Budget Documents for the

respective years. Additionally, data concerning State Government expenditure on the social sector has been obtained from the annual publication of the Reserve Bank of India (RBI), titled "State Finances: A Study of Budgets." Minor adjustments have been made in accordance with the adopted definition of the sector. This research utilizes descriptive and inferential statistics, along with econometric tools, to explore the objectives and test the hypotheses. To analyze trends and patterns, basic statistical tools such as simple averages, compound annual growth rates, percentages, and ratios are employed. The E-Views statistical package has been utilized to investigate the co-integration relationship among the selected variables. One widely used stationarity test, the Augmented Dickey-Fuller Test (ADF), is applied to identify the unit root in the time series data. The Engel-Granger Test, Johansen Test, and Auto-Regressive Distributed Lag Model have been implemented for co-integration analysis in both two-variable and three-variable models. The Vector Error Correction Model and Vector Autoregressive Model are employed to identify short-run fluctuations. Since the methodology used to study the objectives varies slightly for different aims, a detailed methodology is discussed in the relevant article.

### Scope of the study

The current study aims to analyze the trends and patterns of expenditures by both Union and State Governments during the post-liberalization period. The analysis covers a span of three decades, specifically from the fiscal year 1991-92 to the fiscal year 2021-22. With the exception of the fiscal year 1991-92 for the Union Government and 2021-22 for the State Governments, all expenditure figures are nominal actual values. For the years 1991-92 and 2021-22, revised expenditure estimates and budget expenditure estimates are utilized, respectively. The analysis focuses on expenditures in the agriculture and social sectors. The study evaluates the nature and extent of the relationship between growth and public expenditure, using various variables such as Gross Domestic Product, budgetary expenditure of the Union Government, gross value added in the agriculture sector, and public spending on agriculture by both Union and State Governments.

### Review of literature

Jha and Acharya (2011) sought to analyze the trends and patterns of public expenditure, as well as the emphasis placed on India's rural economy, across various budgets over the years. The primary issues they explored in this paper included: trends in the level of public expenditure (considering the budgets of both the Union and State governments) on the rural economy since the 1950s; the composition and prioritization of such expenditure under major categories; and a comparative analysis of public expenditure among States since the early 1990s. The data regarding the share of different development categories in plan expenditure and the state-wise annual average share of expenditure on the Rural Economy within the total expenditure of respective states was sourced from the Economic Survey of India (2010-11) and the Handbook of Statistics on State Government Finances (2010). Additionally, the authors organized this data and presented it in tables and graphs. Ultimately, they emphasized that the efficient and timely use of funds is essential for improving

the productivity of the agriculture sector. They argued that simply allocating funds through budgets is insufficient for achieving better outputs or outcomes. Effective monitoring of how these allocated funds are utilized is critical to meet the established goals and objectives. Sanjaykumar (2020) seeks to examine the trends and growth of public expenditure on education. The research found that public investment in education is steadily increasing at an accelerating pace. Numerous states allocate a larger portion of their GSDP to education compared to the national government overall. Furthermore, it was revealed that the national government continues to invest less than 4% of GDP. Public expenditure on education is growing at a favorable rate. With education appearing on both lists, state government spending on education exceeds the national average. The share of funds that state governments allocate to education is on a downward trend, while the share spent by the national government is on the rise. Despite the upward trends in government spending on education, there is a pressing need to further increase this expenditure. Consequently, government funding for primary and secondary education must be enhanced, and private sector participation in education should be promoted, especially in higher education.

### Major findings and suggestions

1. The nominal expenditure level of the Union Government, referred to as the Absolute level of expenditure in this study, has seen an increase over the three decades following the liberalization era. The Absolute value rose from 111,414 Crore rupees to 3,770,000 Crore rupees during the study period, with an Average Annual Growth Rate (AAGR) of 12.61% and a Compound Annual Growth Rate (CAGR) of 12.45%. This increase can be viewed as modest, especially when compared to the Average Annual Growth Rate of Gross Domestic Product, which stands at just 12.74%. Consequently, Wagner's law, also known as the Law of Increasing State Activity, is applicable when considering the Absolute expenditure from the perspective of the Union Government.
2. The deflated values, referred to as the Real Expenditure level of the Union Government, present a different scenario compared to the Nominal values. The analysis indicates that the Annual Average Growth of public expenditure in real terms is only 6.97%. Thus, it can be concluded that merely 6% of the growth in the Government of India's public expenditure is genuine and can be attributed to real factors, while the remaining 6% increase is a result of price inflation over the years. The per capita spending of the Union Government, whether viewed in Absolute or nominal terms, has risen from 1,250.05 rupees to 27,055.95 rupees during the study period, with an Average Annual Growth Rate and Compound Annual Growth Rate of 10.94% and 10.79%, respectively. However, the deflated values reveal a starkly different picture, showing only a slight increase in per capita spending levels. The AAGR of deflated per capita spending data is 5.39%. The deflated series for both absolute and per capita expenditure raises questions about the true nature and scale of public spending in India.
3. Traditionally, revenue expenditure has been the predominant component of the annual budgetary

spending for both the Union and State governments in any fiscal year. However, the extent of this dominance is significant. The current study reveals that the revenue expenditure of the Union Government increased from 73.86% in the fiscal year 1991-92 to 87.85% in the fiscal year 2020-21. When we examine the annual average growth rate, it stands at 83.36%, while the compound annual growth rate is 80%. This rise in the proportion of revenue expenditure within the total budgetary expenditure is indeed concerning.

4. The capital outlay of the Union government has decreased from 26.14% in the fiscal year 1991-92 to 12.15% in the fiscal year 2020-21. If we analyze the ratio of revenue expenditure to capital expenditure, it has consistently widened from 2 to 8 over the past three decades. Despite the introduction of the Fiscal Responsibility and Budget Management (FRBM) Act and the fiscal discipline measures adopted by successive Union governments of varying ideological backgrounds, capital outlay has not shown improvement in terms of budgetary expenditure. Currently, revenue expenditure is seven times greater than capital expenditure, highlighting the inadequate allocation of resources in an economy burdened by infrastructural challenges.
5. Currently, the Union Government is not adhering to the classification of Development and Non-developmental expenditure. However, if we examine the historical data from the fiscal year 1993-94, we find that both Development and Non-Development expenditure categories have received similar levels of budgetary allocation over the years, with a slight predominance of Non-Development expenditure. In 1993-94, the shares of Development and Non-Development expenditure were nearly equal at 49.62% and 50.38%, respectively. By the fiscal year 2019-20, these shares shifted to 42.93% for Development and 57.07% for Non-Development. The trends indicate that Non-Development expenditure consistently receives a larger portion of the budgetary allocation.
6. The long-term relationship results, derived from the Johansen model, between the Gross Value Added (GVA) of Agriculture and both UGASE and SGASE, have revealed a positive correlation among the variables. The model has been validated as free from issues of autocorrelation and heteroscedasticity. The results indicate that the coefficient value for UGASE is 5.69, suggesting that a 1% increase in UGASE leads to a 5.69% increase in the GVA of agriculture. Additionally, it is evident that SGASE positively impacts the GVA of agriculture during the study period, with a coefficient value of 8.81, indicating that a 1% increase in SGASE results in an 8.81% increase in the GVA of the agriculture sector.
7. The social priority ratio, which pertains to the allocation of funds towards essential human sectors such as Education and Health as a percentage of the total budget for the Social sector, exceeds the UNDP's recommended critical minimum threshold of 50%. Over the past three decades, this average stands at 69.55%, which is notably high. However, the key analysis here is not merely about the magnitude but rather the ongoing trend of decreasing allocations for these vital areas of Human development expenditure. The study

reveals that this crucial ratio has been on a continuous decline, starting with 74.07% in the first decade, dropping to 68.82% in the second decade, and further decreasing to 64.24% in the most recent decade. Additionally, the five-year data aligned with the Five-Year Plans, beginning from the Ninth Five-Year Plan, reflects the same downward trend, with allocations recorded at 73.60%, 74.31%, 71.49%, 67.70%, 66.71%, and 62.86% respectively.

### Suggestions

Some of the policy suggestions based on the present study can be outlined as follows:

1. The public expenditure ratio for both Union and State Governments must be increased to 25% from the current range of 15-18% in order to reach an optimal spending level.
2. The absolute amount of revenue expenditure needs to be reduced from the current level of 80% to facilitate an increase in capital outlay.
3. The annual growth rate of aggregate expenditure for both Union and State Governments should be no less than 5%, taking into account price fluctuations.
4. The study shows a long-term positive correlation between public expenditure on traditional agricultural items, indicating that the Union Government should boost capital expenditure in agriculture instead of merely providing transfer payments.
5. The long-term positive correlation between public expenditure in human priority areas indicates that both Union and State Governments should raise the human expenditure ratio to at least 6%.
6. Careful policy measures should be implemented to reverse the downward trend in social allocation, ensuring that the ratio remains at the upper limit of 70%.

### Conclusion

The present study has undertaken the critical examination of the public expenditure landscape concerning both the Union government and State governments in the aftermath of liberalisation. Through a comprehensive analysis, the study delves into the evolving trends and intricate patterns of public expenditure, specifically focusing on expenditures within the Agriculture sector and the broader social sector. Furthermore, it scrutinises the interplay between the key expenditure variables and their impact on the various facets of economic growth. One of the pivotal outcomes of this research is the clear delineation of the shifting dynamics within India's public expenditure framework. Notably, there is a discernible trend wherein the burden of public expenditure is gradually transitioning towards the State governments. This shift underscores the pressing need for enhanced allocations towards Agriculture and the Social sector, especially in light of the changing demographics and growing population of India. As the nation embarks upon the transformative phase of "Amrit Kaal," it is imperative to place heightened emphasis on bolstering the foundational pillars of Agriculture and prioritising investments in Health and Education sectors. This strategic focus on these life-sustaining sectors is paramount for India to realise its vision of 'Ek Bharat Shreshtha Bharat', emphasizing unity and excellence across the nation.

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