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Fiscal Ramifications of the RPE of India

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ABSTRACT

Though, public expenditure is an intrinsic instrument of fiscal policy to ensure aggregate fiscal discipline and economic stability and growth, in the Indian context it does not seem to have attained the desired out come. The, unprecedented rise in public expenditure, triggered by the growth of the preponderant revenue expenditure, makes less resources available for the areas which could lead to overall development of the economy and reduces private investments. Declining share of capital expenditure is a threat to sustainable development as it fails to spare funds for the creation of productive capital investment. Again, the predominance of the revenue component questions the quality of expenditure calling for its reprioritisation and rationalisation. The Indian situation is a matter of structural affliction like the Achilles Heel, closely interwoven with the imperial legacy of the British. In Indian scenario, government's non-developmental expenditure is guzzling major chunk of the revenues collected, adversely affecting spending in the areas of human development and infrastructure. Moreover, the expenditure growth is not backed by commensurate growth in revenue, leading it to the inevitable deficit-debt corridor of fiscal maladies. Hence to keep the growth momentum going, the need of the hour is to improve the quality of the expenditure on infrastructure and social amenities of the people through reprioritisation and rationalisation of expenditure and adopting scientific Public Expenditure management practices which would lead to enhanced revenue mobilisation and lessen the intensity of the financial squeeze

Keywords: public expenditure, revenue, quality, management, financial squeeze

1.Introduction

Public expenditure is the expenditure incurred by public authorities including, central, state and local self- governments for the maintenance of the governments as well as for the benefit of the society as whole. They cover expenditure on law and order, justice, defence, education, health, infrastructure and other expenses necessary for the maintenance of the government and welfare of the people at large. As against the conventional view of a police state limiting the activities of Governments to police, justice and arms, in a modern welfare state, the horizon of activities of the government has grown in volume and magnitude. The governments have to address various welfare and developmental issues attracting huge public expenditure. As the private sector is usually hesitant and unwilling to invest huge amounts because the returns from such investments are either uncertain or long delayed, it is public expenditure which plays the crucial role in economic development, especially, in underdeveloped economy. Moreover the

Governments are committed to use public expenditure as a lever to raise aggregate demand and thereby to get the economy out of recession, check inflation in the economy, improve income distribution, direct the allocation of resources in the desired lines and to influence the composition of national product. It follows that the growth of public expenditure is a universal phenomenon due to a variety of factors including increase in population (Adolph Wagner) or other exigencies (Peacock and Wiseman).Increase in public expenditure may pause other problems for sustainable fiscal management. It does not mean that increase in public expenditure always ends up in fiscal maladies. The quantum of expenditure is not the real issue but the quality and direction of the expenditure that matters. For instance the public expenditure of USA as a percentage of Gross Domestic Product (GDP) is as high as 38 percent in 2016-17 while the ratio is only 13.27 percent in the case of India, which is still labelled as a developing economy, while the former is a developed one. The public expenditure of the Central Government of India is mainly constituted of the revenue component, which works up to 86.8 percent of the total, limiting productive capital investments. This gives rise to an undesirable situation where, the revenue raised is earmarked for current consumption, precluding capital formation and thus the quality and direction of expenditure get under scanner.

1.Literature Review

Zahir (1972) found that, the growth of public expenditure made very insignificant contribution towards the achievement of social justice. This view was supported by Gupta (1977) who evaluated the extent of the impact of Central Government expenditure on mitigation economic inequality and poverty, the pattern of consumption and the generation of employment opportunities. Barro and Sala-i-Martin et al, (1995) classified expenditures as productive and unproductive. Bose et al. (2003) also examined the effects of government expenditure for a panel of 30 developing countries over the decades of 1970s revealed that the share of government capital expenditure in GDP is positively and significantly correlated with economic growth. Gupta et al. (2005) explain, the composition of public outlays matters concentrated spending on wages tend to have low growth impact while high shares allocated to capital and nonwage goods and services enhance faster output expansion. Verma and Arora (2010) confirmed the absence of any

instantaneous impact of increasing GDP and the size of government expenditure in India. Taban (2010) found no consistent evidence that there is a relationship between government consumption spending Causality between Public Expenditure and Economic Growth: The Indian Case and economic growth in Turkey. Ayo et al. (2011) reported bi- directional causality between government expenditures and economic growth both in the short run and in the long run for Nigeria. Ray and Ray (2012) confirmed the absence of short run causality between economic growth and developmental expenditure of government which neither supports Keynesian approach nor Wagner’s law In India.

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2.Importance

Public expenditure is an integral part of the finances of Governments which mainly centre round its revenue- expenditure process. In discharging sovereign obligations, governments all over the world have to incur public expenditure in varying magnitudes. However till the dawn of the twentieth century, public expenditure was considered a waste and hence remained neglected. Opposing the age old neglect of the importance of public expenditure as an intrinsic instrument of fiscal policy followed by the classical economists like Adam Smith and David Ricardo, JM Keynes came out with the more resurgent proposition that public expenditure is an exogenous factor to be utilized as a policy instrument to stimulate economic growth. This prognosis still holds ground in most nations where Government expenditure or public expenditure is considered as an important tool of fiscal policy which can have profound influence on stabilization and economic growth depending upon its utilization pattern and management by the government. Public expenditures have played an important role in physical and human capital formation over a period of time in many economies. Neverthless, these developments have increased the level of state activities to soaring heights and propelled the growth of public expenditure in size and complexity, pausing serious challenges to expenditure management. In the context of India, too, this remains true as in India; the expenditure growth is not backed by commensurate growth in revenue, leading it to the inevitable deficit-debt corridor of fiscal maladies. For instance in 2016-17, the revenue expenditure stood at Rs 1734560 crores, while the revenue mobilised was Rs1423562crores with the resultant deficit of Rs310998crores. In this context, it becomes important to study the growth of expenditure based on different parameters like Gross Domestic Product, Revenue and other fiscal indicators, for sustainable Public Expenditure Management.

1.Objectives

1. To study the trend of growth of public expenditure of the central Government of India
2. To analyse the mix and composition of public expenditure of Government of India.
3. To analyse the major components of Public Expenditure of Government of India.

2. Methodology

The study broadly follows the methodology suggested in the literature on Union finances and uses the standard tools and techniques. The basic approach is to analyse the trends in revenue, expenditure, receipts and deficits of Central Government of India for the twenty seven year period from 1900-01 to 2016-17.The data for the present study have been primarily compiled from the yearly reports of the Public Finance Statistics of Government of India, Finance Accounts of the union Government audited by the Comptroller and Auditor General of India. The other sources include RBI- State Finances and Budget Documents of Government of India. Percentages, averages, ratios, charts, diagrams and Compound Annual Growth Rates are used to analyse the trend of growth of Public Expenditure while Polynomial trend graphs are used for future projections. A polynomial trend line is a curved line that is used when data fluctuates. It is useful for analyzing expenditure over a large data set. The order of the polynomial can be determined by the number of fluctuations in the data or by how many bends, hills and valleys, appear in the curve

2. Public Expenditure of Government of India - Break up

Total expenditure of the central government comprises revenue and capital expenditure. The Constitution requires revenue and capital expenditures to be shown separately in the budget. Article 112(2) states: "The estimates of expenditure embodied in the annual financial statement shall show separately – (a) the sums required to meet expenditure charged upon the Consolidated Fund of India; and (b) the sums required to meet other expenditure proposed to be made from the Consolidated Fund of India, and shall distinguish expenditure on revenue account from other expenditure"

Revenue expenditure is expenditure incurred for the purpose other than creation of assets of the central government. Revenue expenditure is the expenditure incurred on civil administration, defence forces, public health and education, maintenance of government machinery etc. This type of expenditure is of recurring type which is incurred year after year. On the other hand, that expenditure of the government which led to the reduction in recurring financial liabilities falls under the category of capital expenditure. Such expenditure pertain to payments on acquisition of assets and loans and advances, expenditure on durable assets like highways, multipurpose dams, irrigation projects, buying machinery and equipments etc.

The breakup of total expenditure of Government of India into Revenue and Capital for the period 1990-91 to 2016-17 is shown in Table 1.1.It is evident that revenue expenditure is the predominant component accounting about 87 percent of the total expenditure of the central Government, while capital expenditure works only up to 13 percent. Moreover the revenue component grows much faster with a Compound Annual Growth Rate (CAGR) of 12 percent while the lower share of capital expenditure is supplemented by a sluggish growth justified by a CAGR of 0 .09 percent. Instigated by the pace of growth of the revenue component, the total expenditure also registers a remarkable growth. From Rs 100884 crores in 1990-91,it galloped to Rs 2014407 in 2016-17, recording a twenty times increase during the period. As a share of GDP, the total expenditure comes up to 14.76 percent while the percentage of revenue expenditure to GDP is 12.52, leaving the capital expenditure/GDP ratio as low as 2.24 on average, trailing much behind many countries including neighbouring nations. On a close examination, it follows that the share shows a downward slide. Because of this, the study focuses on the structure and growth of revenue expenditure. The low share of capital

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expenditure is a threat to sustainable development as it fails to spare funds for the creation of productive capital investment. The predominance of the revenue component questions the quality of expenditure calling for its reprioritisation and rationalisation. It is worth noting that the ratio of public expenditure to GDP in advanced countries like France, UK, USA etc fall in the 38-57 percent range, much above the Indian average. Controlling the quality and direction of expenditure through scientific expenditure management practices they use public expenditure as a vital instrument of fiscal policy to trigger economic growth and remains developed nations. The Indian situation is a matter of structural affliction like the Achilles Heel, closely interwoven with the imperial legacy of the British.

Table 1.1
Public Expenditure of Government of India - Break up (rs crors)

year	Revenue Expenditure (a)	% of Total Expenditure	Capital Expenditure (b)	% of Total Expenditure	Total Expenditure (c)=(a+b)	Revenue Expenditure as a % of GDP	Total Expenditure as a % of GDP	GDP at Current Prices
1990-91	73557	72.91	27327	27.09	100884	12.55	17.21	586212
2000-01	277975	88.81	35036	11.19	313011	12.82	14.43	2168652
2007-08	593659	84.57	108327	15.43	701986	11.90	14.08	4987090
2008-09	790593	90.37	84238	9.63	874831	14.04	15.54	5630063
2009-10	905473	89.37	107720	10.63	1013193	13.98	15.64	6477827
2010-11	1036061	87.22	151837	12.78	1187898	13.31	15.26	7784115
2011-12	1145955	89.04	141042	10.96	1286997	13.12	14.73	8736039
2012-13	1237755	88.82	155822	11.18	1393577	12.44	14.00	9951344
2013-14	1366170	88.63	175296	11.37	1541466	12.12	13.67	11272764
2014-15	1484128	88.86	186092	11.14	1670220	11.73	13.20	12653762
2015-16	1531099	86.90	230713	13.10	1761812	10.85	12.49	14108945
2016-17	1734560	86.11	279847	13.89	2014407	11.42	13.27	15183709
CAGR	**0.12**		**0.09**		**0.12**			**0.13**
Average		86.8		13.2	100	12.52	14.76	

Source: Public Finance Statistics- Government of India

2. Composition of Revenue Heads

The revenue heads of Government of India consists of Revenue Expenditure and Revenue Receipts (Table1.2). The analysis reveals that there is a wide gap between revenue receipts and revenue expenditure, leaving huge deficits year after year. Though the revenue receipts grow slightly ahead (CAGR 12.81) of expenditure, it is not enough to negotiate the ever growing expenditure on the way to contain the deficits and the consequent debt component likely to arise. Moreover as a percentage of GDP, revenue receipts average at 9.17 percent, much below revenue expenditure these reigns high at 12.52 percent. This growing imbalance in the revenue side of the budget is an impediment to sustainable development, which may be properly addressed through enhancing revenue mobilisation and management of expenditure. Deficits are hall marks of the national budgets of India ever since the country became a republic. Deficit, however, may also result from government inefficiency, reflecting widespread tax evasion or wasteful spending rather than the operation of a planned countercyclical policy. The situation gives an opportunity to use deficit financing, by borrowings or minting money, keeping the inflationary pressures intact.

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Table 1.2

Composition of Revenue Heads

year	Revenue Expenditure	Revenue Expenditure as a Percentage of GDP	Revenue Receipts	Revenue Receipts as a Percentage of GDP	Revenue Deficits	Revenue Deficits as a Percentage of GDP
	1	a	2	b	=Difference of 1&2	c
1990-91	73557	12.55	54995	9.38	18562	3.17
2000-01	277975	12.82	192742	8.89	85233	3.93
2007-08	593659	11.90	541090	10.85	52569	1.05
2008-09	790593	14.04	537054	9.54	253539	4.50
2009-10	905473	13.98	566475	8.74	338998	5.23
2010-11	1036061	13.31	783810	10.07	252251	3.24
2011-12	1145955	13.12	751328	8.60	394627	4.52
2012-13	1237755	12.44	873474	8.78	364281	3.66
2013-14	1366170	12.12	1009118	8.95	357052	3.17
2014-15	1484128	11.73	1121643	8.86	362485	2.86
2015-16	1531099	10.85	1136628	8.06	394471	2.80
2016-17	1734560	11.42	1423562	9.38	310998	2.05
CAGR	12.42		12.81		11.00	
Average		12.52		9.17		3.34

Source: Public Finance Statistics- Government of India

3. Composition of Central Government Expenditure - Revenue Head

The revenue expenditure consists of developmental and non developmental expenditure. Developmental expenditure refers to the expenditure of the government which helps in economic development by increasing production and real income of the country. They are productive expenditure in nature. Non Developmental expenditure refers, to that expenditure of the government which does not directly help in economic development of the country.

Cost of tax collection, cost of audit, printing of notes, internal law and order, expenditure on defence, Pension etc. are treated as non- developmental expenditure. From Table 1.3, it is clear that non developmental expenditure is more predominant in the composition of revenue expenditure, with an average share of 57 percent of the total ,while development expenditure

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account for 39 percent of the total. Notwithstanding this variation in proportions, both of them grow in tandem with a CAGR of 12 percent. The Statutory grants to States, representing 4 percent of the total, clocks only a meagre growth of .04 percent CAGR. A disconcerting aspect of the Indian fiscal performance has thus been the erosion in development momentum as reflected in a declining share of developmental expenditure in total expenditure at the centre The domineering role of non developmental expenditure stands in the way of economic development as the effectiveness of public expenditure as tool economic development as enunciated by JM Keynes is outdone. The phenomenal growth of no developmental expenditure, driving the growth of total revenue expenditure is better depicted in the following polynomial graph(Figure1.1).Moreover, the polynomial projections show that the total revenue expenditure is likely to cross the Rs 2000000 crore mark by 2020,while the non developmental expenditure is to touch the massive figure of Rs 1500000 crores by the same period.

Table 1.3

Composition of Central Government Expenditure Revenue Head (rs Crores)

Year	**n Developmental Expenditure**	**Developmental Expenditure**	**utory Grants to States**	**Total Revenue Expenditure**
1990-91	43615	26543	3399	73557
2000-01	185667	80279	12029	277975
2007-08	328123	239171	26365	593659
2008-09	410338	352996	27259	790593
2009-10	500226	375549	29698	905473
2010-11	540370	464177	31514	1036061
2011-12	581670	520313	43972	1145955
2012-13	655573	536978	45204	1237755
2013-14	753795	558471	53904	1366170
2014-15	863721	555732	64675	1484128
2015-16	943816	498419	88864	1531099
2016-17	989696	526762	108102	1624560
CAGR	**0.12**	**0.12**	**0.14**	**0.12**
Average Share in Total	57	39	4	100

Source: Public Finance Statistics- Government of India

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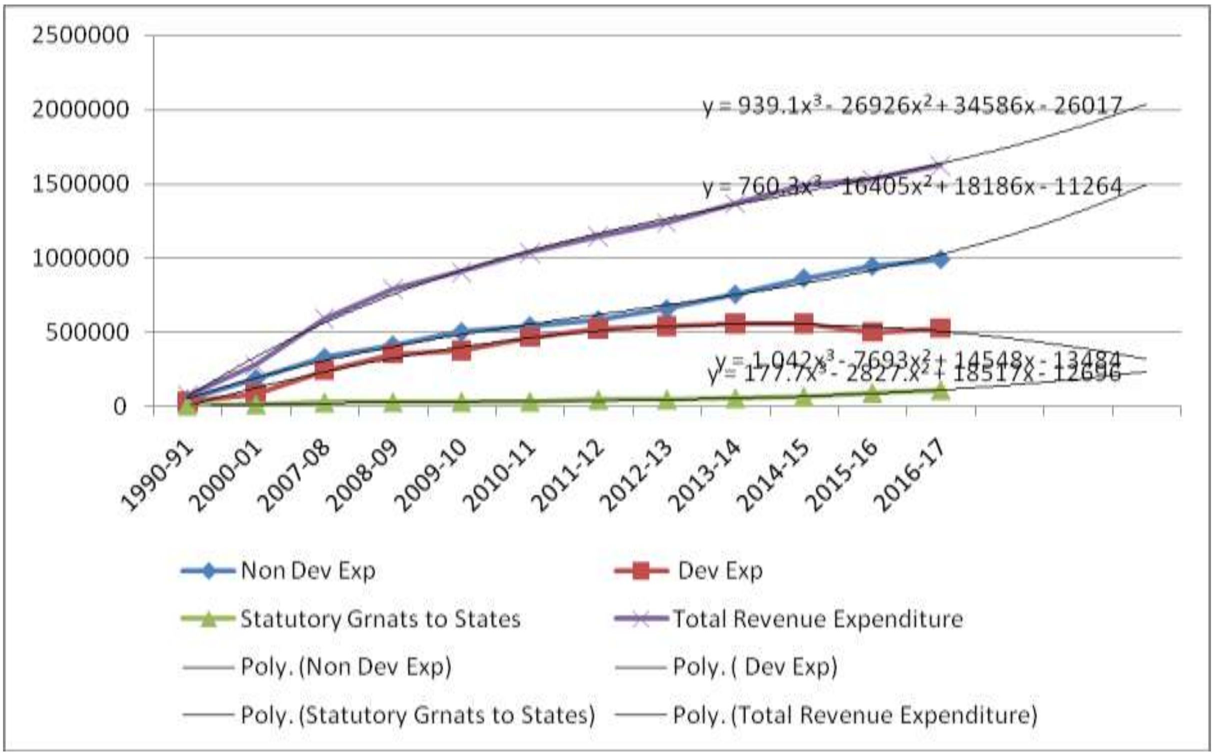
Figure 1.1



Central Government Expenditure Revenue Head-Polynomial Trend (rs Crores)
Source: Public Finance Statistics- Government of India

4. The Non Developmental Expenditure-Revenue head

The distribution of non developmental expenditure is presented in Table1.4.Expenditure on Interest Payments, Defence Services, Pension and Subsidy are the major constituents of non developmental expenditures of which Interest Payments are more preponderant and account for about 47 percent of the total on an average(Figure 1.2).The central Government is under commitment to service the mounting public debt of Rs 7610832 crore in 2016-17,paying interest of Rs 476238 crores for the same at a weighted average cost of 6.77 percent. Defence Services comes in the second slot as the Government is to maintain a large army with arms and ammunitions, equipments and other facilities. As a result, expenditure on defence services, too, records a CAGR of 11 percent, almost keeping pace with the CAGR of Interest which is 12 percent. Subsidy to FCI accounts for about 12 percent of the total and outpaces all other components with a CAGR of 16 percent .Pensions to central government employees is yet another influencing component recording a CAGR of 15 percent next only to subsidy. The propulsion of the various components of non developmental expenditure is matter of concern as much of the revenue is eaten away by these directly non productive items. Government cannot do away with these commitments and hence need to bring about scientific public expenditure management practices including reduction in hierarchies, prevention of leakages, outsourcing, contracting out and implementation of expenditure programmes in a time sliced manner ,upholding the sanctity of legislative sanctity etc.

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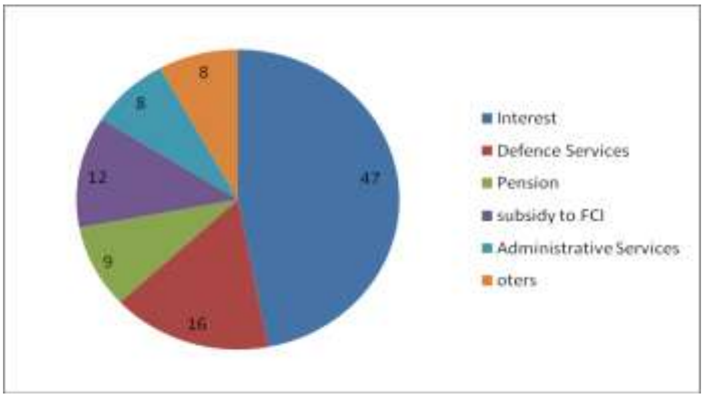
Table 1.4
Non-Developmental Expenditure- Revenue Head (rs crores)

Year	Interest Payments	Defence Services	Organs of State	Fiscal Services	Administr ative Services	Pension	ubsidy to FCI	Others	Total
1990-91	21498	10874	376	1161	2868	2138	2450	2562	43615
2000-01	99314	37238	1603	3030	13401	14220	12060	2641	185667
2007-08	169179	54219	2166	3827	22185	24261	31328	28025	328123
2008-09	192204	73305	2964	5271	31124	32941	43751	39588	410338
2009-10	213093	90669	4193	6535	38754	56149	58443	34684	500226
2010-11	243022	92061	3588	6633	41469	57405	63844	38787	540370
2011-12	273150	103011	4302	7251	47828	61166	72822	23796	581670
2012-13	313170	111227	4424	7880	53509	69478	85000	26407	655573
2013-14	374524	124374	5097	8605	60635	74896	92000	30768	753795
2014-15	411354	140405	5617	10100	69266	81705	122676	63569	863721
2015-16	456145	152139	7819	11804	73148	88521	124419	65719	943816
2016-17	476238	161679	8972	12886	74908	90905	125198	73203	989696
CAGR(%)	0.12	0.11	0.12	0.09	0.13	0.15	0.16	0.13	0.12

Source: Public Finance Statistics- Government of India

Figure 1.2



Composition of Non development Expenditure in percent to Total
Source: Public Finance Statistics- Government of India

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5. Developmental Expenditure- Revenue Head

The Developmental expenditure of the central Government comprises Social and Community Services, General Economic Services, Agriculture and Allied activities, Industry and minerals, Transport & Communication, Grants to States and Union Territories etc. Social and Community Services is the more predominant component; with a CAGR of 13 percent, it works up to 30 percent of the total. Agriculture and Allied activities comes next to it with a CAGR of 14 percent. The expenditure under other segments including Industry and Transport also maintains decent growth rates. It seems as if the Government has succeeded to a great extent in using public expenditure as policy instrument to promote economic development in the country. The much improved growth of the various components testifies the same. In the field of education, public health, poverty alleviations, housing, improved leaving conditions, these expenditures play a vital role. However the declining share of developmental expenditure is a matter of concern which requires revision and reprioritisation of expenditure, particularly when it gets decomposed into different components. The public expenditure management, may also give importance to a greater focus on performance, adequate link between policy making, planning and budgeting, well-functioning accounting and financial management systems and appropriate links between budgeting and other systems of the Government (World Bank's Public Expenditure Management Handbook, 1998),to keep track of developmental expenditure.

Table 1.5

Non-Developmental Expenditure- Revenue Head (rs crores)

Year	Social and Community Services	General Economic Services	Agriculture and Allied activities	Industry and minerals	Fertiliser and Subsidy	Transport & Communication	Grants to States and Union Territories	others	Total
1990-91	5941	2978	3173	1488	4400	932	7100	531	26543
2000-01	23801	1096	8445	3320	13811	10414	17569	1823	80279
2007-08	64405	3322	43734	7210	32490	23834	57527	6649	239171
2008-09	85147	4223	65071	15324	76602	26272	71385	8972	352996
2009-10	99518	3536	62133	26109	61264	35922	77452	9615	375549
2010-11	122409	7310	78543	53990	62301	48158	80868	10598	464177
2011-12	132568	7033	68835	82254	70792	45175	98040	15616	520313
2012-13	139170	5890	72140	110367	65613	33712	101333	8753	536978
2013-14	158556	6191	71950	98944	70933	34082	106652	11163	558471
2014-15	132680	28269	103130	72898	70912	32800	99995	15048	555732
2015-16	147844	28207	103384	44024	72969	32835	52675	16481	498419
2016-17	155432	30132	109987	45287	73987	33210	54876	23851	526762

CAGR	13	9	14	13	11	14	8	15	12

Source: Public Finance Statistics- Government of India

6. Conclusion

The analysis reveals that the expenditure of the central Government of India has increased by leaps and bounds over the years. Though, public expenditure is an intrinsic instrument of fiscal policy to ensure aggregate discipline and economic stability, in the Indian context it does not seem to have attained the desired out come. The, unprecedented rise in the preponderant revenue expenditure, makes less resources available for the areas which could lead to overall development of the economy and reduces private investments. Declining share of capital expenditure is a threat to sustainable development as it fails to spare funds for the creation of productive capital investment. Again, the predominance of the revenue component questions the quality of expenditure calling for its reprioritisation and rationalisation. The Indian situation is a matter of structural affliction like the "Achilles Heel" interwoven with the British legacy. In Indian scenario, government's non- developmental expenditure is guzzling major chunk of the revenues collected, adversely affecting spending in the areas of human development and infrastructure. Moreover, the expenditure growth is not backed by commensurate growth in revenue, leading it to the inevitable deficit-debt corridor of fiscal maladies.

Therefore it is imperative to address properly the issues of lower revenue collections, increase expenditures to revive the economy and control mounting debt levels. Additional revenue generation to finance the ever rising expenditure commitments seems to be a distant possibility in the context of the rough patch through which India is moving at present; with sluggish industrial growth, adverse balance of payments and inflationary pressures. This may force the government to resort to the easiest but dangerous option of borrowings to finance the ensuing deficits culminating into higher interest payment in the future, thereby making fewer resources available for the developmental purpose bleak which would spiral into a debt deficit debacle leading to the inevitable debt trap. Cutting down or compression of expenditure is not a remedy to tide over this fiasco. Instead, to keep the growth momentum going, the need of the hour is to improve the quality of the expenditure on infrastructure and social amenities of the people through reprioritisation and rationalisation of expenditure and adopting scientific Public Expenditure management practices which could lead to enhanced revenue mobilisation to lessen the intensity of the financial squeeze. Public expenditure is a double edged sword which can aggravate the financial crunch on the one hand and bring about economic growth and stability on the other. It is up to the spending agency to regulate the course and direction and quality of expenditure in the desired route through scientific management of public expenditure, revenue enhancement campaigns and deficit reduction packages.

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