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CHAPTER - I

INTRODUCTION TO PUBLIC EXPENDITURE AND ECONOMIC DEVELOPMENT

CHAPTER – I

1.1 INTRODUCTION

Public expenditure is considered by the economists as an indicator or a dosimeter that shows the course of economic development as well as the administrative skill of the government in a country or a governing body. The relationship between economic growth and the volume of public expenditure has been the subject matter of a lively debate among the economic writers in India as well as abroad. There are different opinions in regard to the practicability and desirability of achieving economic growth with the help of the increasing volume of public expenditure. As a matter of fact, public expenditure has grown abnormally in India and abroad; but the study of public expenditure, unfortunately, has not received much attention and suffered from an alarming neglect. Economists of all camps have laid too much emphasis on the study of public revenue and doctrine of taxation and the study of the behaviour of government expenditure has always been treated with indifference in the early days of development of fiscal science. Earlier economists allotted a limited role to the state's functions. They were of the view that the functions of the State were restricted only to the maintenance of law and order in the country and its protection from external invasion. Thus, the limited nature of the functions of the state was the cause, which kept public expenditure in a watertight compartment. In other words during pre-Keynesian era when the classical theories were ruling the doctrine of public expenditure was never conceived to be an important part of fiscal administration. It was Keynes who for the first time popularized the necessity of government's expenditure as a means of achieving economic development as well as an effective tool to combat the ill effects of depression in advanced European countries.

It is worthwhile to note that until recently in India the specialists in the field of public finance were confined to the study of effects of budgeting trends and the development of normative theories focusing at explaining how the behaviors of revenue and expenditure are determined, properly. However, during the last two decades, attempts have been made towards studying the behavior of public expenditure on the basis of empirical data and historical facts with a view to examining the level of economic development in the country. After heavy allotment of funds to be incurred on public welfare programmes and observing the structural changes in government expenditure as a proportion of national income. But the irony of fate is that there has been a general tendency among the economists to think and write only on the problems of All-India scaling and ignore the importance of the study of regional development. It is true that macro studies (All-India) are essential but it is more true to study the economic changes of the country on micro level so as to remove the problem of regional disparities form the economy.

1.2 THEORETICAL BASIS OF PUBLIC EXPENDITURE

The level of any economy depends upon public expenditure. Government's expenditure determines welfare of the people. Budget is an important instrument in the hands of the government that can be utilized for the maximization of public utilities. A budget occupies a dominant place among the special tools of the government employed to regulate and control the affairs of a country. There are some principles of which govern what public revenues shall be raised and what expenditures shall be incurred. Ours is an organized society influencing every walk of the life of the people through is activities. Material and social well being of the community depends upon the scope and nature of such activities. There is no unanimity between the economist and the expert on public finance on a requisite and widely accepted principle or theory of public expenditure. Harries, Samuelson, Musgrave and number of other economists have a feeling that the study of public expenditure has received far less economic attention[1] **(Harris, 1958, p.261)**

1.2.1 PRE-CLASSICAL APPROACH

The science of public finance as we have today was first developed towards the end of Middle Ages as a part of administration and as such formed a large part of the 'Chamber of Science' (Cameralwissenschaft) which was in Germany the forerunner of scientific economics[2] **(Plehn, p.1).** In the days of Camera lists, taxation was not fully developed and much of the revenue which supported the rulers and their governments was derived from the royal or princely domains consisting of cultivated lands (rented to tenants or peasants or directly administered); of forest and of mines; and from dues, rents, fees, and other charges not of the nature of taxes.

The dissolution of the Middle Ages economy both in state and private life and its replacement by the modern system marks the time at which finance as a theoretic study first became possible. The firmer organization of the centralized monarchies of France, Spain and England, the development of money dealing and revolution economic relations produced by the supplies of the precious metals from the New World exhibited a new development of social and political inquiry. Budin (1530-96) observed that a part from the general treatment of political science; the second chapter of the sixth book of his work contains an examination of the various forms of the public revenue. They were grouped under seven heads, the most important being the public domain of import and export duties, and direct taxation. In accordance with the ideas of the mercantile system, Budin approves of customs both on imports and exports, but he distinguishes between 'raw materials' and 'manufactured articles' advocating high export duties on the former, and high import ones on the latter. He thought that direct taxes should be resorted to only in case of necessity and then should be proportioned to 'faculty'. Taxes on luxuries, he regarded it with special approval. The rise of statistics under the name of 'political arithmetic' gave an impetus to the examination of the facts of finance, and, the works of **Pretty[3] (1966)** and Locke considered the question of incidence in taxation. Two of Hume's political Essays (1752) are devoted to 'Taxes and Public Credit' which show traces of the teaching of Montesquieu on the political effects of financial regulations, but also a far greater knowledge of the economical influence of taxation and credit. Hume rejected the Physiocratic doctrine of the incidence of taxation, as also the popular view national debt was beneficial.

The Mercantilists gave an important idea on fiscal principles which were that men should "be taxed according to the benefits they received from the State[4]. Since the State had to protect the nation, the expenditure required for the same was only to come from taxation. There were, however, some slight variations. According to Hobbs, the test for benefit should be expenditure, as the man who saves should not be penalized; while Grotius and Pufendro held that burdens must correspond to benefits received in the shape of protection. **Pretty (1966)** who was the first English scientist writer on fiscal attitude wrote, "It is generally allowed by all that men should contribute to the public charge but according to the share and interest they have in the public place; that is according to their Estate and Riches. In general, the various Mercantilists favored low customs and an increased use of excise in line with their general ideas about the wealth and favourable trade balance to achieve it.

So far as the physiocrats idea on fiscal principle is concerned, it is generally treated as a result of the French against Mercantilists. The physiocrats sought to determine the question of justice in taxation which was opposed to its apparent incidence and its effect on the growth of national wealth, their analysis of the sources of revenue and of the extent to which each could contribute to the public requirements. Quesnay founder of the school and all the members of the group adopted the belief in the superiority of direct taxation on the net product of land, though admitting the temporary use of other taxes. In the strict consistency with their doctrine that only extractive industries produce a surplus, or product net, the physiocrats upheld a single tax on this net income from land, as according to them, all taxes ultimately must fall on land. Thus, it was considered better and economical to collect directly from those who must pay it in the end because every time a tax is transferred, it increases, on account of middleman's expenses. Their idea of a single tax was that it would fall, not directly upon land as a property tax but upon the surplus which land may yield and out of this surplus the tax has also to be paid. According to them all taxes ultimately must fall on land. Thus, it was considered better and economical to collect it directly form those who must pay it in the end because every time a tax is transferred, it increases, on account of middleman's expenses. Their idea of a single tax was that it would fall, not directly upon land as a property tax but upon the surplus, which land may yield and out of this surplus the tax has also to be paid. According to the physiocrats the only branch of production on which taxes could be rightly levied was that which created value and it was agriculture. To tax industry was only to tax the land in a round about way and, therefore, in an uneconomical way. A single tax on land was the financial maxim of physiocracy. Thus, the single tax' system was recommended by the physiocrats and the meant expenditure by the Government on limited items. The greatest advantage of a single tax on land, as thought this school, was that it was not arbitrary. "AT bottom the system affords a barrier against the autocracy of the sovereign-a barrier that is much more effective than a parliamentary vote" **Gide, Charles and Rist (1964)**[5]

1.2.2 CLASSICAL APPROACH

Smith (1776)[9], **Mill (1921)**[11] **and Pigou (1951)** expounded the classical theory approach of public expenditure. They observed that the theory of public expenditure derives its complexion and texture from the theory of state functions. This theory has undergone a drastic change from the 19th century individualistic state, rigidly practicing the orthodox laissez-faire, plea for safeguarding the business cycle theorist's measures for ensuring economic stability are landmarks in the extension of state functions.

The classical approach to the subject of public expenditure was based on the assumption that Government is merely an agent for the people and has to spend the people's money directly and sparingly. In other words, it depends upon the economic fundamental accepted at that time. The approach was based on the assumption of non-interference by the State. The classical economists were staunch supporters of laissez-faire policy. They advocated that the economic role of the state must necessarily be limited and hence there was no worry for the theory of public Expenditure. The classical economists failed to develop a theory of public expenditure in true sense, as "the older English writers did not need a theory of expenditures, because the theory of government which they held implied a fixed limit to governmental functions[6]. The attitude of Classical Economists to public expenditure was characteristically reflected in **J.B. Say**'s famous expression, quoted by **Dalton** "the very best of all plans of finance is to spend little and the best of all taxes is that which is least in amount"[7]

J.B. Say also thought that "every particle of expenditure beyond what necessity absolutely requires for preservation of social order and for protection against foreign attack is waste and unjust and oppressive imposition on the Public [8]. The traditional thinkers inclined to reduce the functions of the government to the minimum possible extent in order that the market mechanism might run undisturbed by institutional forces. This would ensure the achievement of optimum allocation of resources at full employment level and maximization of output in the economy. **Adam Smith**[9] following the physiocrats, finds himself driven to the same conclusion, namely, the wisdom of non-intervention by the state in economic matters. He assumed a limited role to the state as to him government's are always and without any exceptions, the greatest spend thrifts in the society.

Smith Adam recognizes three functions only which the state can perform. The first, duty of the state is to protect the society from the violence and injustice of other independent societies, Secondly, duty of the state is of protecting as far as possible every member of the society from the injustice or the duty of establishing an exact administration of justice. Thirdly, duty of the sovereign, according to Adam Smith, is the duty of erecting and maintaining certain public works and certain public institutions, which it can never be for the interest of any individual, or small number of individuals, to erect and maintain, because the profit could never repay the expense to any individual or small number of individuals, though it may frequently do much more than repay it to a great society. Adam smith's book devoted a long chapter to the Public Debts, thus recording the beginning of an important, then new, phase of public finance...He was against public borrowings as he thought that government would borrow from industry and commerce and thus deprive a capital poor society of revenue which would be productively reinvested. There were other reasons too. For example, borrowing may encourage the sovereign to wage wars; mis-management of funds and higher taxation may encourage flight of capital.

Ricardo, David[10]**,** the other founder pillar of the classical school of economic thought found that public expenditures so wasteful that he never felt it necessary to analyze them. He was interested to endorse the golden maxim of J.B. Say that the very best of all plans of finance is to spend little and the best of all taxes is that which is least in amount **Mill (1921)**. McCulloch and Theirs (1955) were of the opinion that taxes were properly a premium for protection, so the argument ran that public services should be limited to those which serve protection. Those who wished to impose narrow limits on public expenditure. Government functions had to defend their position by the argument increasingly untenable that protection was the only form of benefit that could be derived from the state.

Mill[11] the eminent economist, had similar opinions on fiscal functions of the state. The doctrine of public expenditure reached perfection with Mill. His treatment of public expenditure was based on the perception of inherent in the system of natural liberty that public expenditure should be at the narrowest compass possible. According to him, Laissez-faire, should be the general practice. Every departure from it unless required by some great good, is a certain evil. He stressed that government borrowing to meet the budget deficits is harmful, if it destroys capital, which could otherwise be used for productive employment. Though he has mentioned certain exceptions to the general rule, he was not committed to individuals as an absolute generalization as was the case with Adam Smith. It was partly due to the influence of Banthame on him and as partly on account of the industrial revolution that had intervened since the days of Smith. Mill allows for good deal of government activity in line with his reforming zeal. He applied the test of utility and says that if the greatest good of the greatest number is achieved, the government should step in. He permits government's action in case in which it is required by the interest of the consumer who are unable to help themselves and so when people are acting for others and are not guided by self-interest. Examples of such government's interference are to be found in the opening of schools, scientific experiments and charities. Thus, **Mill** is substantially in accord with **Adam Smith**, except that he gives a much broader application to the principle of interference on behalf of the consumer [12]

While reviewing the ideas of classical economists on public expenditure, it is observed that they advocated it to be at the lowest possible extent. Moreover, they favoured the principle of a balanced budget. But these traditional maxims of public finance are not conducive for the development of an underdeveloped economy because the present, structure of the economy is quite different. In an under-developed economy a rapid economic development cannot be achieved only by the operation of market forces. Social stratification restricts the mobility of labour and there are vast sectors of the economy in which the market mechanism does not rule. In an underdeveloped economy public expenditure becomes a positive tool for fostering its economic development. The instrument of public finance is being consciously used to influence the flow of resources in the interest of planned development and to direct the resources from unproductive investment and consumption into productive investment. **Tripathi**[13] said that public sector expands in size, and, with it grows development expenditure for accelerating the tempo of economic growth in an under-developed economy. The aim of the fiscal policy cannot be obtained by the recognition of classical doctrine of public expenditure which is based upon an unsuited and unsought; idea of the role of public expenditure and balanced budget have got no application in the context of a developing economy where public sector has to play a key role in promoting the growth of the economy.

1.2.3 KEYNESIAN APPROACH

Keynes[14] expounded that the financial discussions, which received greater attention during the period 1890 to 1914 was probably due to the greater pressure caused by the rapid growth of expenditure, which increased as the functions of government, grew in importance and in number. The industrial, commercial and social organizations began to be more and more complex, and one consequence thereof was that it required better and more government organization to keep it running smoothly. This aroused practical interest and compelled reference to general principles. In the years 1914-18 the enormous costs of war caused an abnormal increase in government expenditure. In the post-war period, apart from the burden of debts, public expenditure increased partly because of the increased cost of discharging the old duties of the government and partly because of the new demands for government help during the difficult period of transition from war to peace. However, before the Great Depression the entire fiscal policy was to hold government expenditures to a minimum, to pay the cost by taxation and to repay the national debt as soon as possible. Thus, in spite of mounting expenditures of the government due to its increasing functions and liabilities, the theory of fiscal policy was not yet in evolution.

Before the thirties the discussion on the theory of public expenditure was confined to the four canons (economy, benefit, surplus and sanction) of **Adam Smith** and principle of maximum social advantage. It was the publication of 'General Theory of Employment, Interest and Money' which brought greater advance in this direction. **Keynesian** attack on the traditional principles of budgeting and public finance was a logical extension of his attack on the opinion that the economy tends to equilibrium at full employment level. If there were unemployed resources, which the private sector could not employ, these resources might be put to work by the state by means of additional public outlay, which need not be matched by additional government revenue. According to him, orthodox financial rules must be abandoned.

Lord Keynes has propounded only one theory i.e, the theory of public expenditure (theory of investment), which made him the greatest economist of the 20^{th} century. This is the pivotal theory around which all theories developed by Keynes cluster. In other words, the entire economic doctrines are the direct offshoot of the theory of investment. The theory of public expenditure was proved to be more successful in fighting the ill effects of Great Depression. The importance of public expenditure as a 'balancing factor' in the determination and distribution of national income owes its origin to 'General theory'. He could effectively prove that public expenditure can be used as a balancing factor. If there was an imbalance between investment and savings thereby causing recession or depression in a country, the government could control such a situation by increasing expenditure on public works or transferring income from the rich to the poor whose marginal propensity to consume is higher than that of the former. In a period of depression, current public expenditure should be in excess of current public revenues. Government expenditure will have to be increased to finance relief works, in order to raise the level of employment for the unemployed. In his comprehensive programmes of investment planning, Keynes expects "to see the state which is in a position to calculate the marginal efficiency of capital goods on long views and on the basis of the general social advantage taking an ever greater responsibility for directly organizing investment". At another place he maintains that "somewhat comprehensive socialization of investment will prove the only means of securing an approximation to full employment" in this way, the level of full employment is caused by programmes of investment planning.

Keynes has, thus, revolutionized the entire thinking of public expenditure. His analysis of periodic tendencies to depression in capitalistic economies is based upon the assumption that when national income rises, the volume of savings tends to grow and, probably, more than in proportion to the increase in aggregate income. In other words, the marginal propensity to consume declines as income goes up. Since total employment depends on total depends on total demand, the decrease in marginal propensity to consume due to the increase in income creates a deficiency in aggregate demand, which leads to unemployment. Therefore, there is need to increase real investment to fill up the gap between income and consumption demand out of that income. Here, the public expenditure plays a role to increase demand and create more employment. This new expenditure will, according to **Keynes**, set out a chain of expenditures on the part of the successive income recipients and increase national income to a multiple. The public expenditure is thus, only means to enlarge the volume of effective demand, which in turn increases the level of full employment.

The war gave a new impetus to the thinking on fiscal policy this time with the prevention of inflation as its main objective. **Keynes** was in favour of higher taxes to check inflation. He was mainly concerned with achieving full employment and economic stability and thus he expounded the doctrine of public expenditure to ensure economic stability. In this connection he has advocated the principle of compensatory public spending. The role of expenditure as a compensatory fiscal policy will play an important part to curb large-scale cyclical unemployment and excess capacity.

But the practical applicability of **Keynesian** theory of public expenditure in an underdeveloped economy is quite doubtful. According to Keynes unemployment means involuntary unemployment which is caused by deficiency of effective demand. In India, the problem is not one of deficiency of demand but one of transformation from backward agricultural state of economy to modern industrial power by checking the growth of population and increasing country's resources and productivity. From the point of view of accelerating the tempo of economic development of under-developed economies, it is desirable to use the fiscal tool for restricting the propensity to consume and thus raising the propensity to save as against its use for reducing savings and raising propensity to consume as expressed by Keynes, An under-developed economy has to increase savings progressively by putting fiscal curbs on propensity to consume in order to raise its long-term rate of economic growth. Commenting on **Keynesian** analysis **Tripathi**[15] says that **Keynesian** view of fiscal policy which advocated its use for raising the marginal propensity to consume will have a pernicious influence on the development of an under-developed economy. In the case of an undeveloped economy a rise in the level of investment demands a curtailment of consumption. In this connection, **Ragnar Nurkse (1961)** [16] has also remarked that "Keynes's General Theory has a bias against saving and in favour of spending, but one that is: pernicious when transplanted to conditions in which the under-developed countries find themselves. Thus, its application is limited to countries where early stage of economic development exists. **J.A. Schumpeter (1962)**[17] expressed it in the following words: "Practical Keynesianism is a seedling which cannot be transplanted into foreign soil; it dies there and becomes poisonous before it dies... Left in English soil, this seedling is a healthy thing and promises both fruit and shade...all this applies to every bit of advice that Keynes ever offered. Whatever the generality of the General Theory may be in the sense in which the term general was used by Keynes, the applicability of the propositions of the General Theory to conditions of an under-developed economy is at least limited[18].

Wagner's law and the Keynesian theories present two opposite perceptions in terms of the relationship between public expenditure and growth in community output. While according to Wagner's approach causality runs from growth in community output to public expenditure. The Keynesian approach assumes that causality runs from public expenditure to output.

Wagner's model is not the only one explaining the growth of public expenditure. There are also some other models. For example, the model of the displacement effect and the theory of bureaucracy are also most common ones, explaining the expansion of public sector expenditure from different angles.

Wagner's model for the case of Turkey to analyse whether the data based on the period of 1965-2000 supports Wagner's suggestion or not. To our best knowledge there are two empirical studies based on the Turkish case and examined long run relationship between public expenditure and economic growth. Yamak and Kucukkale's paper examined the period of 1950 – 1994. By taking five versions of Wagner's law, found that there is an empirical support on the Wagner's law of causal relationship from economic growth to public expenditure. Contrary to Yamak & Kucukkale's (1997) findings, Demirbas's study examined the period of 1950-1990 by taking six versions of Wagner's law into account. He found no support on Wagner's law of casual relationship from economic growth to public expenditure and, partly nor Keynesian hypothesis of casual relationship from public expenditure to economic growth.

Despite, the stagnation theory implies that public expenditure would have to be permanently enlarged in order to bridge the gap between investment and savings at full employment levels. The range of instability and evils of stagnation are thereby reduced although by no means removed. The secular upward shift in the consumption function is a result of the secular rise in income and, thus, cyclical Keynesianism is a valid proposition. **Fellner**[19] in his speech of Keynesian economics on its twentieth anniversary points out, "I will add that in my opinion 'cyclical Keynesianism' has survived these twenty years and will continue to be an influential doctrine in the predictable future.' This exhibits that Keynesianism has increased the importance of compensatory spending as a contra-cyclical method to maintain economic stability and prevent secular stagnation.

1.2.4 POST KEYNESIAN APPROACH

Though Keynes himself did not elaborate the role of budgetary theory for full employment extensively, yet other economists of his camp like **A. H Hansen, Dr. Schumachar, Lord Beveridge, Mrs. U.K. Hicks, Dr. Dalton, A. P. Lerner Mrs. Joan Robinson** and **Harrod-Domar** completed his fiscal thinking; **Alvin Hansen**[20] who is called American Keynes vehemently criticized the classical doctrine of balanced budget and suggested to improve budgetary technique so as to make budgets more useful and flexible. He argues, "If one adopts wholeheartedly the principle that government financial operation should be regarded exclusively as instrument of economic and public policy, the concept of a Balance budget desired can play a role in the determination of that policy. Discussing the problem of balancing the budget points out that expenditure incurred by a State can be divided into 'operating expenditure' and 'capital expenditure' some countries, notably, Sweden, in order to exhibit these expenditures adopt what is named a 'double budget', in which the current and operating expenses are accounted for in the operating budget and the capital outlays in capital or investment budget. The rates of taxes and public expenditure should be so fixed at different levels of economic activity that these would stimulate both private and public investments and high mass consumption and thus provide effective demand sufficient to absorb all available labour in employment. **Lord Beveridge (1962),** who was another strong pillar of the Keynesian school, argued that the national budget should be drawn not on the basis of purely financial considerations but on the income and expenditure of the community as a whole. He further said that the primary objective of government's economic and fiscal policies should be to achieve the goal of full employment of human and material resources, so that poverty and misery, unemployment and starvation may be removed from the national economy. But **Dr. Dalton**[21] has different view on the budgetary structure. He observed that the budget should be balanced, but, in the short-run, measured in terms of a year or two, in the long-run, the budget need not be balanced. It means that **Dr. Dalton** was partly with classical heritage and partly with Keynesianism.

Lerner[22] while following the Keynesian line of thought maintains that the volume of employment depends on the rate of spending. There are five elements in the total spending of the economy consumption and investment by the individuals, consumption and investment by the government and investment by businesses. Any policy for full employment has to work on one or more of these five elements, which make up the total spending on currently, produced goods and services. Deflation is the result of inadequate total spending and its cure lies in increasing one or more of the elements in total spending. On the other band, excessive total spending results in inflation and its cure lies in diminishing one or more of the elements in the total spending. According to Lerner, the government has three main fiscal weapons for fighting deflation. It can increase total spending directly by increasing its own purchases or by spending indirectly by inducing individuals to spend more by giving more money away in pensions, subsidies and social securities benefits to people who will spend it, or by taking less money away from people in taxes so that thy will have more money to spend. Total spending may be enhanced by government going directly into the loan market and lending money or repaying some of its debts. In exactly the same way the government has three different ways, in which it can reduce total spending when it is excessive and causing inflation. Thus buying and selling, giving and taking money to or from citizens and leading and borrowing are three pairs of fiscal instruments available to the government for increasing or reducing total spending and fighting inflation and deflation respectively. In an underdeveloped economy, the prevention of inflation and deflation by regulating total spending is a subsidiary problem. The main is the progressive stepping up to the tempo of economic growth. **Harrod-Domar** growth models are purely laissez-faire ones based on the assumption of fiscal neutrality and designed to indicate the conditions of progressive equilibrium. In growing economy (**Harrod-Domar** type) two fundamental roles have been assigned to fiscal policy. The first rôle is that of the stabilizer where it has to ensure that the 'growing output resulting from the full use of capacity will be purchased at stable prices; and the second role is that of capacity generator where it may also strive to alter the rate of growth of capacity output itself. [23] In its stabilization role fiscal policy has to bridge, any gap 'between planned saving and planned investment. This resembles the role of fiscal policy in the static Keynesian model. This stabilization role of fiscal policy will seek to maintain equality between the warranted and the actual rates of growth once an initial level of full employment has been achieved. The second rôle of the fiscal policy is dynamic one, and it has no counterpart in the static Keynesian model. These two roles of fiscal policy are closely related in a growing economy,, because the task of the authorities is to act as investor's as fiscal stabilizers or as both in such a way as to bring about the rate of output growth that fully utilizes output capacity and at same time equates planned saving and investment[24]. **Musgrave**[25] has assigned similar roles of fiscal dynamics when he says that the problem of fiscal dynamics in economic growth is one of securing a growing level of capacity income at stable prices. In such an economy the problem of ensuring the purchase of growing output at suitable prices is not very important because there is always a pressure of money demand on the limited productive capacity of the economy. It is not the demand-generating role of investment, which is important in an underdeveloped economy; it is its capacity generating role, which should be the dominant consideration in fiscal dynamics for economic development in such an economy[26]. Thus, the principal objective of public expenditure in the economic development of underdeveloped economies is to expand productive capacity by raising the level of real capital as compared to its role in developed countries where it has to expand both productive capacity as well as the level of monetary demand. It implies that in expanding productive capacity of contributing to the growth of investment, fiscal dynamics in underdeveloped countries has to keep the demand-generating effect of growing investment in check.

'**Gopal M.H.** [27] states that the doctrine of public expenditure bears intensity of priorities in an underdeveloped economy because the means of disposal are limited. Defense expenditure is the most important item of expenditure. National defense, as **Smith** remarked, is more important that opulence. No state in the world can neglect expenditures on security services because it defends internal; peace and protects freedom from external invasion. Expenditure on defense is more urgent to the democratic welfare state than the social services themselves **Gadgil**[28] talking on education remarks that it is universally believed that defense expenditure does not increase national income directly or the welfare of the community but its ignorance may hamper not only the, happiness and welfare of the community but the sovereignty of the country may also be in stake. Thus, in the list of expenditures priority should be first given to defense expenditure.

Expenditure on social overheads, such as, health, education, housing, etc. also requires to be given high priority because that would be necessary not only to enthuse the working population but also to assure an increasing supply of healthy and skilled labour for executing the development programme. **Myint**[29] rates that it is now widely recognized that many developing countries my be held back not so much by a shortage of savings as by a shortage of skill and knowledge resulting in the limited capacity of their organizational framework to absorb capital in productive investment. Thus attention has now shifted from capital to education, from investment in material capital to investment in human capital. Furthermore, **Vakil and Brahmanand**[30] point out that social overheads expenditure would also be a step in the direction of a better and more equitable distribution of income and wealth so as to establish a socialistic society.

The order of priorities outlined above is more or less in tune with the famous Soviet Union's technique of "planning with unbalanced growth. Soviet Union, it seems, was obliged to adopt this technique for accelerating the tempo of its economic growth because it found itself economically surrounded by a capitalist world. This technique with slight modifications already stands accepted by the Indian Planning Commission. While these are the suggested priorities to be observed, there are certain principles, which the planning authority should always keep, view, while planning its development expenditure.

In the first place, as suggested by **Prof. Gunnar Myrdal**, an underdeveloped economy should not permit its public expenditure to be directed by the market forces. In other words the planning authority should not allow itself to be swayed by profit considerations in setting, up new enterprises in the public sector. A public enterprise may not be profitable from the market point of view but that is no reason for not going ahead with it. An enterprise may not be profitable itself but it might help in bringing into existence certain external economies, which may be essential for the growth and development of other enterprises.

Secondly, **Lewis W.A.**[31] stated that the planning authority, in planning its development expenditure should be cautious enough to see that it does not go beyond the limits of the physical resources available. It is foolish to plan for more investment than the available physical resources will permit. It is quite a common error with most of planning authorities that they initiate so many investment projects simultaneously that the available resources of certain basic commodities such as textiles cement, steel, machinery labour and so on are insufficient to cope with all of them.

Thirdly, the planning authority should endeavour to meet as far as possible the development expenditure from budget surpluses. **Prof.H.W Singer**[32] has duly emphasized the importance of keeping with the limits of resource-availability in order to avoid inflation. But in developing economy the expenditure is of such a high magnitude that it is not possible entirely to meet is from the budgetary surpluses and some resort to deficit financing becomes inevitable. A developing economy is especially prone to inflationary pressures.

On the ground of above analysis, it may be concluded that the ideas relating to the need and the effects of public expenditure have varied over time. The earlier Economists advocated that the government should not interfere in the economic life of the people. But in modern times the important idea regarding the principles of public expenditure is that the government should spend more to accelerate the tempo of economic development of a country. In an underdeveloped economy the role of public expenditure is very much recognized as its leads to a transformation from absolutely backward economy to forward economy by injecting more money into the economy. Public expenditure is the harbinger of innovation in the economy through the creative role of the entrepreneur. Thus, modern theory of public expenditure makes it clear that no economy can go ahead in the race of economic development, without accepting the importance of the role of public expenditure in the economy. In conclusion, one may say that there is only one principle of public expenditure, which states that the State should incur its expenditure in such a manner as to achieve maximum benefit for the whole economy.

1.3 THEORETICAL FOUNDATION

The concept of public expenditure play a great role in the process of economic development and its importance is increasing every day, since the developing States have started assuming so many functions in economic life of the people. **Nurkse**[33] states that public expenditure assumes a new significance in the face of the problem of capital formation in under-developed countries". Therefore in this context, public expenditure holds the same position in the discussion of public finance as planning holds in the study of economic development. **Mehta and Agrawal**[34] have stated "Just as consumption is the end of all activities, so public expenditure is the end of all fiscal affairs of the State"

Therefore, it is felt necessary to reflect on the impact of public expenditure on the level of employment, production and income, achievement of optimum allocation of resources, stability of prices, the creation and maintenance of full employment and a better distribution of incomes particularly in a developing economy, where taking into consideration the backwardness of the economy, the responsibility before public authority is enormous. It should be noted that the influence of public expenditure on levels of economic activity and on distribution, would depend upon the nature of the government in place. And the period during which public expenditure is incurred.

Therefore in this study we have followed Kenesian Ideology and we have tried to study the effect Public Expenditure on Economic Development. Here Public Expenditure is taken as independent variable and Economic development as dependent variable.

1.3.1 PUBLIC EXPENDITURE AND ECONOMIC DEVELOPMENT

Public expenditure is the second name of economic development or better to say, it is a synonymous of economic development. In modern times public expenditure has become popular like the mineral oil without which the car of economic development cannot run speedily so as to achieve a rapid transformation from backward agricultural state to a modern industrial power. So, this rapid transformation cannot be possible without huge expenditure on the economic front. **Schumpeter[35] and Hicks[36]** have made a distinction between economic growth and economic development. They explained that Economic development refers to the problem of under-developed countries and economic growth to those of advanced countries. "The problems of under-developed countries are concerned with the development of unused resources even though their uses are well known, while those of advanced countries are related to growth, most of their resources being already known and developed. However, the problem of under-developed countries is to make rapid and accelerated economic development, i.e., the rapid increase in the output and incomes of the community while that of developed countries is to maintain economic stability, a gradual and steady advance in incomes and output".

Meier and Baldwin[37] and Nag[38] opined that economic development is a process whereby an economy's real national income increases over a long period of time. They considered real national income of a nation as one of the important constituent elements and determinants of economic development of a developing country. The most commonly used test for diagnosing an economy as under-developed is the low ratio of industrial output to total output or of industrial population to total population. In this way an under-developed economy is one that is characterized by lack of saving potential and immense reserve of unskilled human and material resources.

Lewis[39] examined that economic activity, increasing knowledge and increasing capital stock are the three main harbingers of economic growth. Of these factors the last is considered to be the most significant factor, which accelerates the tempo of economic development, though many social scientists have been cautious to assert that capital is a necessary but not a sufficient and independent condition of economic growth.

Nurkse[40] defined that economic development means increase in capital per head of population. The under-developed countries are hampered by the stick of vicious circle of poverty and stagnation created by low level of income, saving, capital formation, unscientific technique and low productivity. Regarding capital formation he has opined that "The country's incremental saving ratio or to vary the jargon of the marginal propensity to save is crucial determinant of growth. Increase in the rate of capital formation requires stepping up of the rate of saving and investment in the economy of a country." In this connection the case of developed countries is quite different. In these countries the level of per capita income is adequately high and so there is no problem of capital formation and as a result adequate volume of saving is effortlessly generated in the economy. It is generally observed that in under-developed economies the level of saving and investment is not more than 5% to 6% of the national income. Further, the bulk of the voluntary saving is misdirected into gold reservation, hoarding and conspicuous consumption. To overcome these difficulties of under-developed countries, the state has to initiate and sustain the programmes of economic development. Therefore, an acceleration of the pace of capital formation requires direct state interference in economic and social domains in such a country, because a programme of planned and balanced development including investment in different fields of production alone can succeed in breaking the bonds of stationary equilibrium of under-development. Public expenditures incurred by the state have to play a positive and dynamic role for the promotion and acceleration of the rate of economic development in these countries.

Thus, public expenditure for promoting the economic development of under-developed countries may have the following important aspects.

First is to promote and accelerate the growth of productive investment in the economy both in the public and private sectors. Secondly, to mobilize the maximum volume of real and financial resources for investment plan of the public sector, keeping in view the expenditure demand for real and financial resources of the private sector and in this way, to promote the growth of marginal and average rate of savings the economy. Thirdly, to promote and maintain a reasonable measure of economic stability so as to attain the maximum rate of growth of the economy. Fourthly, to make a serious effort for rational distribution of growing national output.

UN Report[41] observed that the fiscal roles played by the State for stepping up the economic development of the under-developed countries are as an investor, as a saver, as a stabilizer and as an income distributor. It has also advocated the same objectives of fiscal policy for the rapid economic development of under-developed countries which may be summarized as follows: Firstly, to remove existing inequalities in the distribution of income and wealth by expanding the internal markets and reducing unessential imports, Secondly, to check inflationary pressure prevailing in the economy with the help of growing economic development in the desired direction for the goodness of the people and Thirdly, to accelerate the tempo of economic development, it is essential to increase the total volume of savings.

It was observed that public expenditure is an important fiscal weapon, which will have to assist economic development, ensure economic stability and reduce existing inequalities in the distribution of income and wealth in the economy. The increased proportion of additional output should be utilized for capital formation so as to accelerate the economic development of an under-developed country. In the first place, the government budgets should be raised high, so that a rising proportion of additional output may be available for development purposes and secondly, an increased proportion of government revenues should be earmarked to finance expenditures on development. Investment expenditure programmes should be planned in such a way to fulfilling both the short run and the long-run objectives of fiscal policy. The biggest problem, which the under-developed countries face, is the problem of unemployment and low incomes. Public expenditure programmes may directly help to provide employment programmes to many individuals and by increasing people's demand for goods and services, it may further increase the employment opportunities as the increase in demand will lead to greater production and better distribution and, thus, will provide employment to a large number of people.

Dalton[42] states that "until recent years, this aim was generally conceived as that of steadying employment at some level which allowed for considerable, though much more nearly constant, unemployment". It is, however, true only, if productive instruments on agriculture and industry are not producing what they can produce. If these are already making production at optimum level, the possibilities of increasing production and employment would be bleak. Thus, public expenditure programmes should be so devised so as to increase demand for the products. In other words, the principle of growth with stability should be followed. The public expenditure should not only aim at increasing demand but also at stimulating and supplementing private initiative and enterprise. He observed, "Broadly, such a policy will substitute saving, either by public authorities or by private persons for spending. There are very large possibilities here, which modern governments have hardly yet begun to explore. The government with the help of public expenditure may enter directly into production activities and enterprise to achieve the objective of balancing the peculiarities of demand with supply for optimum production.

UN, World Economic Survey[43] opined that the private sector may be encouraged for making rapid investment and increasing production, if public expenditure is liberally incurred for the provision of social and economic overheads education and public health, provision of means of transport and communications and power etc. "Improvements in public health, provision of means of transport and communications and power etc. It is observed that "Improvements in public health confer a common benefit on all classes, but the greatest benefit on the poorest. Public expenditure should create external economies and internal economies to facilitate production. This may increase production and consumption and may provide better incomes and better standard of living to the countrymen. Keynes stated that "whereas taxation, taken alone, may check production, public expenditure, taken lone, should almost certainly increase it".

The public expenditure should step into those enterprises, which do not attract private sector. Where private capital is shy to enter into those enterprises, because of low profit margin or because they entail huge capital investment and take long time to give returns. Thus all the key and basic industries needed for making rapid economic development, such as iron and steel, atomic power hydroelectric, multi purpose projects, heavy electrical and engineering come under this category. However, the objective of public expenditure in mixed economy like India should not be to compete with the private sector investment but supplement and complement each other. Keynes further examined that in under-developed countries the use of positive theory of public expenditure should be the beginning and not the end point in the decision making process for determining future public expenditures. So martin and Lewis (1960) have suggested introducing positive public expenditure theory for having maximum social advantage to the people.

1.3.2 PUBLIC EXPENDITURE ON ECONOMIC OVERHEADS

UN, Economic Bulletin for Asia and the Fast East[44] argues that public expenditure on different means of transport and communications such as construction of rail and roads, communications, power installations, generation of electricity, flood control and soil improvements are the necessary ways for the expansion of both domestic and international trade, and through such market enlargement, it brings numerous small isolated economic units into a wide exchange economy, thus stimulating further specialization and increase in output and efficiency. With the attainment of cheap, fast and far reaching means of transport, farms and industries, formerly distributing to relatively scattered and nearby markets, find that they can now serve a larger market area just as well, by forming larger and more efficient production units. Hence public investment incurred on the means of transport not only adds to the national income of its own services, but far more important than this it makes an indirect contribution to the national income and economic development through the expansion of almost all sectors of the economy.

Besides providing facilities for widening the area of market, public expenditure on transport helps also to make accessible new resources. In several areas of the under-developed countries, good agricultural soils, vast area of forests and immense reverses of minerals are known to exist in abundance. Yet owing to their inaccessibility, known resources are left unused and potential resources remain unexplored. Even when man has access to land and other natural wealth, "Lack of transport has often resulted in only partial utilization. Thus, it is a apparent that public expenditure on the different means of transport helps also in stimulating the development of those industries which supply equipments and services to the available means of transport itself. As for example we may say that the construction and operation of railways and rods assist the smooth growth of coal mining, iron stone cutting and different minor and major engineering services. So it induces industrial development coupled with market expansion made possible by different means of transport development and constitutes an important element of economic take off.

From the above observations, therefore, it is established that public expenditure on the development of different means of transport accelerates the tempo of economic development in the following three main ways: First one is by enlarging the scope of market and thereby further stimulating economic specializations, Secondly, by helping the exploitation of additional resources by making them accessible. Thirdly, by establishing and by enlarging the area of related industries.

1.3.3 PUBLIC EXPENDITURE AND BALANCED REGIONAL GROWTH

In a developed economy, public expenditure may be helpful in the field of balanced growth of different segments of the economy by allocating economic resources between deferent regions. In Gujarat, it is found that the northern part of the state is more backward in comparison to the southern part, as in case of the former, farming is the main occupation of the people which is hampered by the uncertainties of rainfall, whereas, the southern part is rich in various types of minerals which raise the money income of the people by providing employment. So there is a gap between southern and northern part of the state. One is industrially advanced and the second half of the state is backward in the field of industrialization and the problem of regional imbalances arise. This problem can only be solved by the initiative of public and private hands through larger investment. So public expenditure may be made in order to attain in the state. Dalton Hugh remarked that deliberate guidance, by financial inducement of new industries, public or private, into depressed areas may make for a fuller utilization of immobile and unemployed resources and thus lead, even at some initial cost, to increased aggregate production later. With the help of public expenditure a balanced regional development of different regions can be had either by promoting private investment in more backward areas or by taking direct responsibility of investments by the State in those areas. It may be boldly said that expenditure is the harbinger of balanced economic growth by reducing the acute problem of regional disparities prevailing in each and every corner of the economy of Gujarat.

1.3.4 PUBLIC EXPENDITURE AND ECONOMIC STABILITY

Committee of the American Association[45] argues that Public expenditure plays a vital role in the field of economic stabilization. Price stability means the absence of any market trend or sharp short-term movements in the general level of prices. Economic growth and price stability have sometimes been regarded as antithetical. But now there is a general agreement among the economists that the economic growth and price stability are the common objectives of planned economic development of under-developed economies. Today the controversy is not over the desirability of economic growth and stability but only over the interrelationship between them and over the policies necessary to achieve them. The question is only whether there is any possibility of conflict between the goals of growth and price stability that may call for special measures to reconcile them or whether prices of inflation and the related external imbalance can always be met by monetary and fiscal restraints without any danger to economic growth.

Keynes[46] examined that trade cycle is a common characteristic of a market economy. The market forces by themselves leave much to be desired in the sphere of economic achievements. Fully advanced and free market economy is more marked with fluctuations in income, employment and prices. With the rapid growth of capitalism, the laissez faire economies have experienced even stronger units of trade cycles. Accordingly it was necessary to adopt some effective anti cyclical measure to ensure stability in the economy particularly at the time of Great Depression of 1930s when monetary expansion and falling rate of interest all failed to pull the economy from the ditch of depression. As **Keynes**[47] has pointed out the fundamental cause of the ills of advanced market economy was the deficiency of effective demand, which was caused on account of a low marginal propensity to consume, accompanied by declining marginal efficiency of capital. According to him, trade cycle may be regarded as being occasioned by a cyclical change in the marginal efficiency of capital through complicated and often aggravated by associated changes in the other significant short period variables of the economic system. Thus, the primary cause of cyclical fluctuations are changes in the volume of investment which are in turn caused by the cyclical fluctuations in the marginal efficiency of capital, i.e., changes in the expected rate of profit on current investment. Keynes further emphasized that the marginal efficiency of capital depends upon businessmen's expectations regarding the rate of future return from investment, and this expectation is determined by "the uncontrollable and disobedient psychology of the business world". He, therefore advocated and continuous injection of additional purchasing power in the market through stimulation of consumption and investment activities and through direct public investment. This direct public investment was a part of the public expenditure. Such public expenditure represents the direct increment in effective demand in the market and generates a high value multiplier by distributing income in favour of those sections of the population who have a high marginal propensity to consume.

Under a deflationary situation or during periods of depression, growth in public expenditure helps to sustain in a community. Public works even of doubtful utility may pay for themselves over and over again at a time of severe unemployment, if only from the diminished cost of relief expenditure, provided that we can assume that a smaller portion of income is saved when unemployment is greater, but they may become a more doubtful proposition as a state of full employment is approached. Where there is excess of effective demand over the available supply of goods and services, prices tend to rise and this will happen if output cannot be increased because of some bottlenecks in the economy or the existence of a full employment situation. Under such situations an inflationary spiral will develop in the economy and a reduced volume of public expenditure will help to bridge the inflationary gap, which measure the excess of consumption, investment and government expenditure over the available output at current prices. Unless the inflationary gap is bridged, prices will tend to rise. Further it often happens in an economy that savings are in excess of intended investment or intended investment is far in excess of the available supply of savings. The government can meet this critical supply of savings. The government can meet this critical situation by regulating the volume of public expenditure so that more is spent in a situation of excess savings and vice versa. Of course, there are limitations to such anti cyclical public expenditure policy. However, if blue prints for certain projects are kept ready so that they can be undertaken to postpone projects, public expenditure helps the maintenance of stable conditions in an economy.

Now the question arises: What should be the role of public expenditure during an upward phase of a business cycle? It is an anti-inflationary measure in the process of economic development. In the state of inflatión, consumption and investment spending are increasing. Compensatory public expenditure should be so controlled and managed that the level of full employment is achieved in an ordinary manner.

When the economy takes a turn from the low level of depression and starts recovering gradually, the compensatory spending of the previous period, which would be at a fairly high level, would continue. In other words, in the initial stages of recovery, public expenditure would continue to be large and the government budget would continue to show a deficit. But as soon as the recovery has gathered momentum sufficiently, the government should reduce its expenditure progressively. As expenditure decline gradually, governments' revenue will rise especially with the rise in income and employment and the budget may be balanced. As the economy reveals the level of full employment, government compensatory expenditure should be completely stopped. The government budget should be designed to yield a surplus so that the past debt may be paid off. And in this way public expenditure paves a right way for smooth and rapid economic development of a country by curbing inflationary pressures prevailing in the economy.

1.3.5 PUBLIC EXPENDITURE – COMPENSATORY FINANCE

Dillard[48] defined compensatory spending as the use of public expenditures to make up for the fall of private spending so as to maintain a full employment level of income. Such a policy means different things in different periods. For example, during the period of depression, compensatory spending will involve heavy government expenditure on public works programmes. During a period of recovery when private investment has started picking up, public expenditure may be reduced gradually in the same ratio as the rise of private investment has started picking up, public expenditure may be reduced gradually in the same ratio as the rise of private expenditure, and finally, during the period of business prosperity and boom, when private demand for goods and services is rising rapidly and even assuming dangerous proportions, government expenditure should be reduced considerably so that there would be a surplus i.e., excess of taxations over public expenditure. If over investment is the true cause of the business cycle, the remedy for a slump would be to raise the rate of interest in order to check excessive investment during the boom. Keynes, however, is opposed to rising rate of interest for the purpose of checking investment during expansion. He suggested that a depression could best be avoided if creating conditions that will maintain a high rate of investment perpetuates the boom.

These fiscal instruments like tax, public borrowing and public expenditure act more effectively as stabilizer. As **Van Philips**[49] has put it that " The direct impact of this policy is not formed by total effective demand, but by the volume of capital goods (private and public) which as a result of government activity will show a balance, a more continuous increase than if it were left to cyclical fluctuations. The government thus continuously takes part in investment activity to a larger extent during a depression, while by restricting itself in the upswing; it leaves room for the increase in induced private investment". Furthermore, the short-term counter cyclical objective of fiscal policy will have to be integrated with the long-term objectives in underdeveloped countries such as, the achievement of a rapid rate of growth without inflation and equitable distribution of national income.

In the above discussion it may be concluded that despite certain difficulties in bringing about economic stability, the public expenditure is more reliable and dependable that interest rate policy. Public expenditure programme alone may not be adequate to tackle the problem of instability. It will have to be armed with judicious combination of the import and export subsidies, duties and other necessary steps. Any way Philip further opined "increased public expenditure in many of these directions is desirable in order to bring about that distribution of the country's resources between different uses, which give the best results, balancing without bias the present and the future".

1.3.6 PUBLIC EXPENDITURE AND INCOME DISTRIBUTION

Planning Commission Government of India (1951-56)[50] envisaged that under-developed countries generally suffer from the problem of inequalities in the distribution of income and wealth distribution that warrants immediate remedy. Growth with justice demands that fruits of economic development should be evenly distributed. Greater production and better distribution have been rightly accepted as the main objectives of planning in India. The Directive Principles, as laid down in the Indian Constitution , envisage a society in which all have equal opportunity to work and right to be provided with work, a social order in which there is no exploitation of he economically weak by the stronger and where disparities in income and wealth are minimized.

First Five Year Plan (1951-56) envisaged that it is no longer possible to think of development as a process merely of increasing the available supplies of material goods. It is necessary to ensure that simultaneously a steady advance is made towards the realization of wider objectives such as full employment and the removal of economic inequalities. The second plan mentions "reduction of inequalities in income and wealth and more even distribution of economic power", as one of the principal objectives of the plan. The third plan reaffirms the objective of the second plan with a slight modification, "to establish progressively greater equality of opportunity and bring about reduction in disparities in income and wealth and more even distribution of economic power".

The common policy that runs through all the plans is that both for social and economic reasons increase in national income alone is not enough, there must be a simultaneous process of distributing the national income more equitably. With a resolve to raise the living standards and economic status of the underprivileged, the Fourth Plan has reaffirmed the objective of Indian economic planning in the following words:" Planning should result in greater equality in income and wealth that there should be progressively reduction of concentration of incomes, wealth and economic power and that benefits of development should accrue more and more to the relatively less privileged classes of society"

Similarly the opening page of Draft outline of the fifth plan starts with the following references: "The twin causes of poverty are under-development and inequality. Thus, it appears that the problem of inequality of income and wealth has already been posing a problem before our planners, policy makers and executors of the programmes. Efforts made so far in this direction by different plans do not sound happy note. Inequalities in income and wealth are greater now than they were at the beginning of this period of planned development, and while the economy continues to be mixed one, the ingredients of the mixture are making it conform more clearly to a capitalist than a socialist pattern.

However redistribute function of public expenditure programme is always emphasized both in developed and underdeveloped countries. Public expenditure exerts wholesome influence on income distribution. It is considered to be an important instrument by which inequalities of income and wealth can be reduced to a greater extent. It is observed only that system of public expenditure can reduce inequalities of income.

Tripathi[51] emphasized on the creation of social overhead capital as "one of the basis pre-requisites for the acceleration of the rate of economic development, eliminates the dilemma between the objectives of alleviating the glaring inequality of income and the objective of increasing the rate of capita formation". In this way, distribution of income raises peculiarly different problems for the less developed countries because the policy makers wish to ride two horses simultaneously, namely, the horse of economic equality and that of economic development. For successful implementation of a programme of public expenditure attuned to the acceleration of the rate of economic growth the under-developed countries should pay serious attention to the solution of a number of important problems. Then only public expenditure may act as an important and effective fiscal tool for attaining the goal of economic development with stability and ensure rational distribution of income and wealth in the community.

1.4 DEVELOPMENT OF GOVERNMENT EXPENDITURES IN INDIA AND GUJARAT

The development of Government expenditures in India and Gujarat had its origin in the works of the British fiscal model. On the 15th of August 1947 India attained its independence from the British colonial Government its public finance / expenditures and the existence of a strong Central Government, etc are still visible in the sphere of fiscal atmosphere of the Indian government. Therefore, Indian public Finance / expenditure is a direct outcome of the British fiscal model.

Gupta[52] observed that public Finance / expenditure in India has grown up mainly on the British pattern. The British model is apparent in such things as the selection of the financial year from April to March, the form of the budget and the system of its presentation, in the methods of control of expenditure and in the strong central position of the Ministry of Finance. England has outdistanced of the nations in matters of financial administration. Government budgeting took its roots in this country, from where it spread to all other countries. Naturally, Indian financial administration is a direct offshoot of the British model.

1.4.1 GOVERNMENT FINANCIAL ADMINISTRATION

Government of India (1952)[53] Ministry of Finance developed financial administration for central Government budgeting / expenditures as well as State Governments for the economic development of the country. This is that part of public-finance, which consists of principles and practices, involved in the conduct of the financial businesses at the center and state Governments. India being a democratic and parliamentary form of government has a comprehensive administrative machinery where the people or their elected representatives, the legislators control the purpose of the government. It was observed that about two months before the beginning of the financial year, various government departments send their requirements of money to the financial Department of the government. On the basis of that estimated expenditure, a budget is prepared by the Finance Minister pointing out the need of money in that financial year, the method of raising that money, the types of various taxes, the rates proposed, the need of credit, the types of various taxes, the rates proposed, the need of credit, and also the items on which the money would be spent. The budget is then presented to the legislators who pass it either in that form or with some amendments. The government then appoints a machinery for the collection of revenue in the authorized manner and the spending of the same in discharge of functions assigned to it. These authorities have to maintain records and books of accounts, which are thoroughly audited by an officer independent of the executive. In short, it is in this manner that financial administration is run in a democratic country like India.

1.4.2 MEANING AND SIGNIFICANCE OF THE GOVERNMENT BUDGET

In India, the Government budget is known as the "Annual Financial Statement" which is placed by the Finance Minister before parliament. This financial statement relates to the estimated receipts and expenditures of the Government of India for the coming year beginning with the first of April and ending with 31st of March. In States too, similar statements are annually placed before the respective legislatures. Being a federation, India does not have one budget for the whole country, but has a number of budgets: one for the Central Government and, one, each fro the State Governments. **Tylor P.E.**[54]

defines budget as the master financial plan of government. It brings together estimates of anticipated revenue and proposed expenditures implying the schedules of activities to be undertaken and the means of financing these activities. **J.B. Say** has given an incomplete picture of the budget. He is of the opinion that the budget is a document to bring out a balance between the needs and the resources of the State. A budget is the account of activities of the central Government, presented by the Chancellor of the Exchequer on Budget night. The task of budget policy is to contribute to an efficient allocation of resources and a 'proper' distribution of income. The famous French fiscal theorist Rene Stourm opines that "the budget of the state is a document containing a preliminary approved plan of public revenues and expenditures". Jene70 describes a 'budget as a forecast and an estimate of all the public receipts and expenses and for certain expenses and receipts an authorization to incur them and to collect them". The budget occupies a central place in the sphere of public finance /expenditures. It is central instrument of financial administration. Taylor boldly called it a "Master Financial Plan of Government". Thus, a budget is a mirror through which one can look the face of the revenue an expenditure position of the government." Thus, a budget is a mirror through which one can look the face of the revenue and expenditure position of the government. It indicates the goal and the process to achieve that goal.

Premchand[55] observed that "Performance budgeting is essentially a process which, by an organized society pattern of display and exhibition, brings out the total governmental operations through a classification by functions, programmes and activities. Through suitable narrative statements and work-load data that form an integral part of the presentation, it indicates the work done, proposed to be done, and of the cost of carrying them out". The main purpose of a performance budget is to raise public comprehensiveness of the budget in terms of the policy objective, it is designed to serve. Burkhead[68] opined, "budgetary programmes are inherently forward looking, a projection of the economic and social policies of government. Performance must be based on the record of prior accomplishment. In the preparation of the budget estimates, programmes determination should precede and set the framework in which the measurement of performance can be undertaken". In India all the departments of the Central and State Governments prepare performance budgets. These types of budget present the main programmes, activities and projects of the Government in connection with the desired objectives and an evaluation of the previous year's budgets and achievements are examined. But, in India too, these budgetary techniques have not proved them effective because of several bottlenecks.

Burkhead[56] opined that object classification is the most universally recognized form of classification for budget expenditure. It is considered as a grant improvement in the mechanism of budgeting. It keeps strict control over expenditure and restricts the discretion of the government personnel. The object classification was the direct product of an era when both legislators and the citizenry at large were filled with distrust for administrators. It was a great technical step forward in budgeting, since it permitted the installation of government accounting systems, which could be linked with budget accounts and thus limit defalcations. Under this classification, expenditure can be controlled at departmental level. This type of classification is being adopted in India under three heads-Major, Minor and sub-heads, which indicate the objects of expenditure. It lays strong emphasis on the accounting aspect of fiscal administration in the government.

1.4.3 FUNCTIONAL AND ECONOMIC CLASSIFICATION OF THE GOVERNMENT BUDGETS

The fiscal authority has a two-fold task at the time of presenting budget. The first is related to the expenditure side. It has to be ensured that the money is allotted and spent in a way that will most successfully and effectively achieve the desired goals. The second on the other hand, is related to the revenue side. Here the fiscal authority has to see that the incidence of taxation is evenly distributed. The first task is considered to be the main problem of budgeting. Modern government is held responsible not only for disbursement of public purse but also for balancing the national economy. Thus, the chief considerations are the objectives to be achieved by government expenditure. This calls for a classification of public expenditure based on the types of services rendered. This type of classification is known as 'Functional Classification'. This classification may also be called a 'people's classification'. The primary objectives of functional classification are to show government expenditure on immediate or short-run purposes served.

UN report survey[57] on the ground of Functional Classification, government activities may be grouped under the following heads: General Services, community Services, social services, economic Services, and Unallocable.

General Services stand for primary duties of the Government like national defence, justice, police, general administration etc. Community services consist of services offered for community living like sanitation, water supply, roads, etc. Social services include responsibilities like education, health, etc. Economic services represent all kinds of activities which are carried out by the public enterprises. Under this scheme of classification, interest on public debt, foreign transfers etc.

can't be included and, all these types of expenditures, which cannot be related to specific purposes, have been grouped under the head "unallocable". It includes transfers to foreign countries i.e. grants to Nepal, Butan, Bangla Desh and Shri Lanka; technical credits and other loans to foreign countries etc. The revised version of these was also introduced to the Government of India in 1974[58].

Similarly, there can be functional classification of revenue. It may be in accordance with main heads of receipts like income tax, excise etc. in the center, and land revenue, sales taxes etc. in the States. The functional classification of budget is certainly the best possible method of budget presentation in summary type. It represents a people's picture of government activities.

U.N World Economic Survey[59] explained that economic classification, on the other hand, is required to provide data that are relevant and useful to analyze the effects of government transactions on the economy of the country. Economic classification of budget is conducive for distinguishing between, "payment for capital formation... payment for government consumption... payments (such as social security benefits) and receipts (such as taxes) which redistribute the income of the rest of the economy; payments (such as loans and advances) which make funds available for capital formation by the rest of the economy, and receipts (such as loans and advances) which make funds available for capital formation by the rest of the economy, and receipts (such as borrowings) which transfer part of savings of the rest of the economy to the government".

Sharma[60] remarked that this economic classification brings out such important aggregates as public expenditure of the consumption kind, public investment, and the draft of public authorities on private savings for financing the development outlays in the public sector. The functional classification would categorize public expenditure under such heads as general administration, defence and security services, education, health, social security services etc. by combining the two, a cross-classification may be attempted to underline the economic significance of public expenditure in main fields of governmental activity.

Thus, an economic classification of the budget can prove very helpful in arriving at various measures considered proper for securing different goals of the economy. It provides material for policy making. This type of classification supplies significant data necessary for formulating the economic policy of the government, especially in regard to the promotion of economic development without sacrificing stability. In under-developed countries like India, an economic classification is a pre-requisite to the implementation of programmes for an increase in capital formation and an improvement in the standard of living of the people.

1.4.4 ECONOMIC AND FUNCTIONAL CLASSIFICATION OF GOVERNMENT EXPENDITURES IN INDIA

Row[61] envisaged "International economic institutions have tried in the past to introduce and to promote conceptual clarity and uniformity which in turn form the basis for conceptual clarity and uniformity of Economic/Economic-Functional Classification of Government's budgetary transactions in the system of national accounting and to provide international guidance to national statistical authorities who wish to improve, elaborate and extend their national accounts and their system of basic statistic'.

The Economic Division of the Ministry of Finance of the Government of India has been presenting an economic classification of the Central Government budgetary transactions since 1957-58 in pursuance of the recommendations of ECAFE workshop Session held at Bangkok in 1955 on budget reclassification according to which a supplementary classification of government transactions into economic and functional categories was also be presented so as to make budget a more effective tool of fiscal control in the field of economic and social policy formulation. Economic classification attempts to arrange the expenditures and receipts of the Government along with those of railways and posts and telegraphs by placing in important economic categories, making difference between current and capital outlays, preceding expenditure from goods and services from transfers to individuals and institutions, tax receipts by kind from other receipts and from borrowing and inter-governmental loans and grants, etc. so far as the introduction of functional classification in the Indian budgetary system is concerned it is a direct offshoot of annual plan outlays and the budgetary outlays. The main aim of the budgetary classification into functional categories is to watch the allocation of resources on different functions in a manner as the priorities given in the drafts of the plan. Accordingly, since 1967-68, the cross-classification i.e. an economic cum-functional classification has been introduced in India.

The framework of economic classification is based on the description of Central Government transactions, which is also adopted by state Governments to execute their public expenditures in economic development of the country. These are in a set of six accounts used under the head of economic classification as what follows:

Account 1: represents transactions in commodities and services and transfers, which constitute the current account of the Government administration. It is concerned, on the expenditure side, with the Government's consumption expenditure and current transfer payments; on receipts sides, it covers tax receipts, income from Government property and enterprises and fees and miscellaneous receipts. The surplus arising out of the excess of current revenue over expenditure on consumption and current transfer payments stands for the saving of the central Government administration.

Account 2: starts with a slight difference related to the current account of departmental commercial undertakings. In this account the expenditure side covers the current expenditure of the undertakings such as wages and salaries, pension, payments, purchase of raw materials, repairs and maintenance, interest charged to the undertakings, profits retained by the undertakings etc. on the other hand the receipts side includes their gross sale proceeds and the interest receipts on their outstanding balances in capital and depreciation funds. The surplus of receipts over expenditure is partly transferred to the current account of the Government administration and partly saved as retained profit.

Account 3: comprises of transactions in commodities and services and transfers in the capital account of Government administration and departmental commercial undertakings too. Its disbursements cover gross and net capital formation and net increase in work stores. The receipts side shows gross savings and capital transfers of both. The deficit on all transactions in commodities and services and transfers mentioned in this account results in total loss of the Government and Indicates its net indebtedness to the rest of the economy.

Account 4: is related to changes in financial assets of the Government administration and the departmental commercial undertakings in the capital account which covers investment in share capital of industrial and commercial concerns and loans of the Central Government including the deficit in Account 3 represents the total requirements of finance to be met out of borrowings and by the deficit financing.

Account 5: represents changes in finances of the Government administration and departmental commercial undertakings in the capital account which shows the borrowing accounts of the Government to be financed for meeting deficits emerging from Account 3 and 4. the incomings of the account include gross market borrowing, external debt, net accretions to small savings, provident funds, special borrowings from the R.B.I. against compulsory deposits etc. the outgoings, on the other hand, are concerned with repayments on account of market borrowings and foreign loans. The balance emerging from this Account represents the net increase in financial liabilities and together with adjustment in cash balances is equivalent to the sum of balancing items in Accounts 3 and 4.

Account 6: represents the cash-and capital reconciliation account of the Government administration and the departmental commercial undertakings. This is the reconciliation account summing up the net position in respect of Accounts 3,4 and 5 and showing the effect of all transactions of the Central Government on its cash position.

A functional classification is mainly concerned with expenditures of the Government and does not apply to receipts. It is related to the total outlay of the Government composed of current expenditure in Account 1, capital expenditure in Account 3 and financial investments and loans and advances in Account 4 of the economic classification. These three Accounts represent expenditures, which can be related to specific purposes to be served by Government policies.

1.4.5 PLAN AND NON-PLAN EXPENDITURE

Government expenditure can also be classified into plan and non-plan expenditure. Plan expenditures refer to the expenditure incurred by the Central Government on programme / projects, which are recommended by the Planning commission[75]. Non-plan expenditure, on the contrary, is a generic term used to cover all expenditure of government, not included in the plan. Non plan expenditure consists of many items of expenditure, which are obligatory in nature and also essential obligations of a state. Items of expenditure, such as interest payments, pensionary charges, and statutory transfer to states come under the obligatory nature. Defence, internal securities are essential obligations of a state. Any neglect of these activities can lead to collapse of government. Besides there are special responsibilities of the Central Government like external affairs, currency and mint, cooperation with other countries and the expenditure incurred in this expenditure of the Central Government, interest payments, defence, subsidies take the lion's share of expenditure.

1.4.6 DEVELOPMENTAL AND NON- DEVELOPMENTAL EXPENDITURE

Government expenditure of Government of India can be classified into developmental and Non-Developmental expenditure. Developmental expenditure comprises expenditure incurred on education; medical care, public health and family planning, labor and employment, agriculture, cooperation, irrigation, transport and communication and other miscellaneous services. Expenditure incurred on these items both on revenue and capital accounts is also treated as developmental expenditure. Non-Developmental expenditure, on the other hand, comprises expenditure incurred on items like defence, collection of taxes and duties, administrative services, interest on debt and other services, stationary and printing and other expenditure on general services. Development expenditure contains social services and economic Services. Non-development expenditure involves General Services and Unallocable.

Table 1.4.4.6 show that the development expenditure has increased much more than the non-development expenditure and as a result the percentage of development expenditure to total expenditure has increased from 56 % to 59 % between actual and budget. So far as the growth of non-development expenditure is concerned, it has declined proportionately from 44 % to 41 %. Of the total expenditure budgeted for 1979-80 the provision for social and economic services is estimated at Rs. 10,474.2 crores or 58.82 % of the total expenditure. The expenditure on general services is estimated at Rs. 3804 crores for 1979-80 i.e. 21.36 % of the total expenditure. Under the scheme of functional classification adopted in this item it covers besides defence and civil expenditure, such items as capital outlays on administrative buildings, and non-plan grants and loans for natural calamities to states and Union Territories. The unallocable items include statutory grants-in-aid to States, non-plan grants to Union Territories, food and other consumer subsidies, interest on public debt, pensions, aid to foreign countries and stock-piling of foodgrains which, however, has become significant with the transfer of procurement and distribution of foodgrains to F.C.I. these unallocable expenditures, accounting for 19.82 % of the total expenditure in 1979-80 are estimated at Rs. 3529.8 crores fro 1978-79.On balance it can be said that the fundamental difference between economic and functional classification is that the former studies both the expenditure and revenue of the Government, while the latter is only concerned with the expenditure of the Government and not with revenues.Table No.1.4.6.1 represents the position of growth and trend of the Government's expenditure under functional classification.

Table1.4.6.1 : Total Indian Government's Expenditure

(Rs. in Crore)

Expenditure	1977-78 Accounts	1978-79 Revised	1979-80 Budget	% change (2/4)
1	2	3	4	5
1. Development expenditure	8437.6	10764.0	10474.2	24.14
a) Social Services	970.2	1235.7	1336.1	37.71
b) Economic Services	7467.4	9528.3	9138.1	22.37
2. Non development expenditure	6548.0	7510.2	7333.3	11.99
a) General Services	3271.2	3690.4	3804.0	16.29
b) Unallowable	3276.8	3819.8	3529.3	7.71
Total (1+2)	14985.6	18274.2	17807.5	18.83

Sources : Government of India, An Economic and Functional Classification of Central Government Budget 1979-80,pp 14-16

1.4.7 PREPARATION OF THE GUJARAT STATE BUDGET

Under Article 2.2(1) of the Constitution, a statement of estimated receipts and expenditures of Gujarat in respect of each financial year, known as Annual Financial Statement, is laid before the Legislature by the Finance Minister on behalf of the Government. The financial statement properly known as 'Budget' contains actual expenditure of the previous year, sanctioned expenditure for the current year and the probable expenditure for the ensuing year. That is the reason why in every budget there are budget figures for three years. The financial year begins on April 1 and ends on March 31. The estimates of expenditure embodied in the Annual Financial Statement shows separately two main classes of expenditure-one class, which is subject to the vote of the Legislature and the other, which does not require the vote of the Legislature. The latter class of expenditure is described as "expenditure charged upon the consolidated fund of the State". These two classes of expenditure are commonly known as "voted" and "charged" expenditure, Government of Gujarat (1961) [62]

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The Budget in Gujarat for a particular year is presented to the legislature usually four weeks before the close of financial year ending on 31st March, so that the whole of the discussion may be completed before the new year comes in. the work for the preparation of budget estimates for the next financial year starts in the month of September of the current year. The estimating officers submit proposals involving new expenditure through their Heads of Departments to Administrative Department in the Secretariat by the 15th September. Other estimates (of standing and continuing charges) are submitted by the Estimating officers to the Heads of Departments to Administrative Department in the Secretariat by the 15th September. Other estimates (of standing and continuing charges) are submitted by the Estimating officers to the Heads of the Departments by October 1. The Heads of departments submit the estimates to the Administrative Departments, Finance Department and the Accountant General, Gujarat, after consolidation estimates, in the month of October. The comments of the Accountant General and the Administrative Departments are received in the month of October. The comments of the Accountant General and the Administrative Departments are received in the month of November. After the discussions on the budget proposals start between the Secretary of the Finance Department and the Secretaries of the Administrative Departments, as also between the Finance Minister and other Ministers in the month of January. In the first week of February, the budget is submitted to the Cabinet for thorough discussion and consideration. In other words, the explanation of increases and decreases are also given and they are compared with the current year. The Department concerned, and the Accountant General scrutinize the first part of these returns; while the Finance Department and the

Accountant General review the second part; and, the third part is that which is very carefully scrutinized by the Department concerned, as well as by the Finance Department. The Finance Department scrutinizes each scheme in its financial implications, immediate cost, and ultimate effect, and then submits it to the Cabinet; the budget is presented to the Legislative Assembly by the end of February or in the first week of March every year, about three weeks before the commencement of the new financial year.

Before the presentation of the budget, it is customary for the finance Minister to review the economic situation in the State during the ensuring year and he delivers his speech in the Legislative Assembly giving critical review of all the items of revenue and heads of expenditure, the Capital Expenditure programme, and ways and means, for handling the finances of the State during the current year.

A few days after the presentation of the Budget, a general discussion on the Budget proposals starts in the House which lasts for three or four days; wherein, the members get an opportunity to hold an interesting debate and to criticize or comment upon each and every item of the Budget-so to say-the policy of the Government. This discussion enables the Government to know the pulse of the House. Then separate demand for grants for each department is taken up, discussed and voted. The estimates of receipts are not subject to voting. There is no voting on the estimates of the "charged expenditures" the taxation proposals of the Government are dealt with separately in the finance bill. A laid-down procedure for the voting of grants is adopted. A period of eight to ten days is devoted for the purpose and if the discussion is not ended by 5.p.m. on the last day, the speaker of the House applies "Guillotine" which means that many of the estimated grants are passed without any discussion. A Bill is introduced to provide for the appropriation out of the consolidated Fund of the

State. The Governor of Gujarat assents to the approved Appropriation Bill and budget is finally signed by the Governor.

In order to reap the benefits of expert advice it is suggested that a Budget Preparation Committee be constituted with the Finance Commissioner as its head consisting of top executives, financial experts and economists. The experience shows that in recent years there has hardly been an occasion when a full-fledged budget for a financial year has been presented in Gujarat. The presentation of interim budget to obtain a "vote on Account" for authorizing expenditure for three months has become an usual practice. An exception has become almost a permanent rule. This injects uncertainty in the execution of different plans and projects and the entire projection of the estimates about income and expenditure is distorted. This reflects lack of confidence and determination on the part of the Government. It is in the interest of the State's economy and administration that such practices should be discouraged. The financial year starts from the 1st April and it ends with the 31st March. This practice does not suit our situation. When the budget is finally passed by the 31st March, allotment for the different heads reaches the work points by the months of June and July. In case of major public works of construction and earth-work-nature preparation of estimates and allotment of works etc. take at least two months and when the deck is cleared for starting work rainy season starts and in this way actual work starts either in the month of December or January. Hardly two months are left to complete the work and to spend the allotment. Every body is aware of the nature of March-loot marked with all sorts of bungling, misuse and misappropriation of fund in a bid to avoid lapsing of the fund and its surrender. If the present financial year of 1st April to 31st March is changed to 1st September to 31st August, there will be more time available for execution of the work and better use of the fund allotted for different work-heads.

1.4.8 EXECUTION OF THE BUDGET

The execution of the Budget is the function of the Administrative Departments through the various Heads of the departments and their subordinates. The tax collection has been one of the problems of the State Government. The District Magistrates, in addition to other works, also supervise the collection of land revenue as collectors through a team of subordinate officers. In case of indirect taxes, the Government has to deal with smaller number of persons and the collection of revenue is comparatively easier. But a large staff is required to collect the taxes and to prevent tax evasion. The money, thus collected, is deposited in the State's treasuries.

Soon after the Budget is passed by the Legislature, the grants are offered to the disbursing and controlling officers. The expenditure against appropriations is carefully adopted by dividing the grants into primary units of appropriations, i.e., the salary of officers, establishment, contingencies, allowances and honoraria, supplies and services, grants-in-aid contributions and donations, works assignments and compensations, establishments charges payable to other government departments, refunds, reserves etc. such appropriations are some times further divided for purposes of financial control, and they are enforced only until the close of the financial year which requires considerable control to avoid extravagance and rushing through of expenditure in March. Before any public money is actually spent, it is necessary to acquire both administrative sanction and budget provisions. With regard to the Engineering Works, in addition to the above, technical sanction is also to be obtained which covers the approval of balances and estimates. The paying authority has to see that the expenditure does not exceed the authorized limit, that the documents for each claim are genuine, and that a receipt in due form is given.

A separate finance account is prepared and presented to the Legislature along with a report of the Auditor General, which provides complete information regarding the public accounts for the year under Receipts and Expenditures. The audit report on the accounts includes the salient features of the current revenue expenditure and indicates the financial results of important public works together with a complete analysis of the audit position of the state. The Auditor General's report is usually of particular interest as an authoritative and impartial view of public accounts.

1.4.9 CONCLUDING REMARKS

The present survey of theoretical discussions provides a base for the study of role of public expenditure in economic development that have been accepted as positive theories of economic growth such as Adam Smith's Wealth of Nations, Samuelson's Pure Theory of Public Expenditures Mill's Principles of Political Economy, Keynes's Government Theory of Employment Interest and Money, Pigou's Study of Public Finance, Dalton's Principles of Public Finance, Lewis's Principles of Economic Planning / Theory of Economic Growth, Ricardo David's Principles of Political Economy, Wagner's Theory of Public Expenditure and Economic Development, Schumpeter's Theory of Development, Peacock and Wiseman's Growth of Public Expenditure in the United Kingdom, Taylor's Economics of Public Finance, Hicks's Development from Below/Development Finance-Planning and Control, Lewis's Economics of Control, Gupta's Government Budgeting, Row's Economic Functional Classification of State Government Expenditure in India.

The survey of the possible theoretical explanations of public expenditure and economic development discussed in context to the present Chapter, has widely covered developed and developing countries. It is found that these studies have different, opinions in regard to the practicability and desirability of achieving economic growth with the help of the increasing public expenditure Thus, public expenditure has grown, abnormally, in India and abroad; its study, unfortunately, has not received much attention and suffered from an alarming neglect. The survey of the possible theoretical explanations of public expenditure in India shows that there has been a general tendency among the economists to think and write only on the problems of All-India scaling and ignore the importance of the study of regional development. It is true that Macro studies (All-India) are essential but it is more true to study the economic changes of the country on micro level so as to remove the problem of regional disparities from the economy.

Therefore, due to these shortcomings, it was felt necessary to undertake the present study in order to examine role of public expenditure and economic development of Gujarat State, India.

Though, this is not an exhaustive survey of the literature and findings of empirical work in this area. We feel that it does provide analytical framework for enabling us to undertake the present study.

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