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Government Expenditure and Macroeconomic Parameters of India in Post Liberalisation Period

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Abstract

The active role of state through an increased level of government outlay has been key determinant of aggregate demand in India and thus led to enhanced growth rate coupled with active participation of private sector in 1990s. The sound macroeconomic parameters, albeit, with intermittent variation do profoundly tells success story of market friendly economic reforms vis a vis dynamic & effective state intervention through state sponsored market friendly measures to boost aggregate demand in post liberalisation period.

Keywords: Macroeconomic parameters, Aggregate demand, Government Expenditure, Private sector, Economic Reforms, Capital formation

1. Introduction

In context of public finance an expenditure incurred by the state is an inherent instrument of the fiscal system of a nation. The absolute size, relative growth pattern and efficiency of public expenditures consequences in reduction of economic inequality, leading to more inclusive growth and development of the nation. This aspect of the study of public spending was neglected till 1920s by classical economists like Adam Smith, J B Say, David Ricardo who considered an interventions by the state in market activities as a waste and adversely affecting the private capital formation. Contrary to the belief of classical school of thoughts, Keynes considered public expenditure as an exogenous factor to be utilized as a policy instrument to stimulate economic growth. According to the Keynesian economists, private sector decisions sometimes lead to incompetent macroeconomic outcomes requiring intervention by the government through fiscal & trade policy and the central bank via monetary policy to stabilize output. [1-6]

The propagation of macroeconomics thoughts in general and particularly profound acceptance of active role of state after the 1930s worldwide recession led the developmental role of government and welfare state through expenditure on various public utilities and provisions of public goods. In post-colonial India, central government in close association with state governments led the active state role through creations of massive core infrastructure project like canal and irrigation development system, mega electricity generation projects, iron and steel plants, cement manufacturing units etc and provisions of public utilities like transport, education, health and housing for commons. The significant proportions of Union and state government’s annual budget outlays channelled to provide public amenities and to ensure public welfare. In year 1991, the very beginning year since the adoption of liberalisation regime central government spending as a percentage of GDP was approximately 15 percent which observed sustained reduction in early 1990s and it reduced to 14 percent of GDP, a lowest level since new economic policy(See fig 1). The government spending has increased gradually form mid 1990s to year 2003 and remained well above

14 percent of GDP till global financial crisis, with marginal reduction in year 2010 it observed a rising upward trends.[7-12]

However, central government expenditure in developing countries like India is relatively low compared to economically advanced countries like USA who spends more than 20 percentage of GDP denotes significant contribution of the state in aggregate demand.

Fig 1 Central Government Expenditrue (India & USA) as share of GDP, 1990-2016

Source : World Bank online database

2. Government Expenditure and its contribution in aggregate demand 1990-2020

All kinds of government consumption and investment are considered as Government spending (see fig 1 & 2). Though, it can be sub-categorized into various subheads on the basis of different criterion but according to aggregate demand perspective it is classified into government final consumption expenditure (acquisition of goods and services by the government for current use to directly satisfy individual or collective needs of the society), gross fixed capital formation (acquirement of goods and services for future benefits such as infrastructure investment, research spending) and transfer payments(see fig 2).

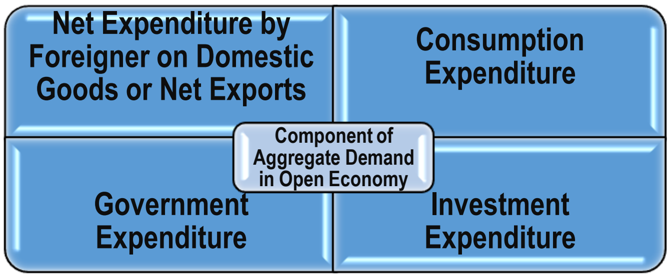

Fig.2.Components of Aggregate demand in Open Economy

The absolute level of central[1] government outlays has seen sustained rise from year 1990-91 at a level of 100884 crore rupees to 313011 crore rupees in year 2000-01 more than threefold increase in the decade and 2125434 crore rupees in year 2017-18, a rise of multiple of seven during seventeen years(see table 1). The average growth rate of government expenditure has been 21 percent per annum during 1990s compared to 2000s whereas average growth rate has been 28 percentage per annum during 2000-2010[10-13].

Table 1Parameters of Government expenditure 1991-2020 (Rs. crore)

Year	CGE	Combined Exp (state &center)	Aggregate Demand (GDP_{MP})	CGE % OF Aggregate demand	Com exp % aggregate demand	Fiscal Deficit	External Debt
1990-91	100884	155142	586212	17.21	**(26.47)**	37606	3676
1995-96	185233	293104	1226725	15.10	**(23.90)**	50253	318
2000-01	313011	552124	2177413	14.38	**(25.36)**	1188116	7505
2005-06	501083	933642	3693369	13.57	**(25.28)**	146435	33365
2010-11	1187898	2105695	7784115	15.26	**(27.05)**	373591	23556
2015-16	1814958	3783712	13771874	13.18	**(27.47)**	522791	12748
2016-17	1996069	4505509	15075429	13.24	**(29.89)**	534274	14873
2017-18	2125434	4861640	16847455	12.62	**(28.86)**	546532	15789

Source: Public Finance Statistics, Ministry of Finance, GOI various issues from Year 1995-96 to 2018-19 figure in () represents as a ratio of GDPmp.

The contribution of central government in aggregate demand (measured at GDPmp) is more than 15 percent of GDP, as a significant contributor to the growth of the economy CGE plays a pivotal role to transfer and redistribute income to weaker sections of the society through various welfare and centrally sponsored schemes. As the macroeconomic theory on open economy argues that a small fractional increase in government spending have multiplier effect on economic activities through Keynesian fiscal multiplier. A closer look at the composition of aggregate demand in 1990-91 and 2000-01 reveals that government final consumption, which is the largest component of government expenditure, has remained unchanged (see fig4).

3. Combined (centre and state) expenditure and its share in aggregate demand

Governments (Central, State and Local governments) incur expenditures to satisfy the collective social needs of the people, to correct market distortions as well as to regulate private activities hazardous to the society. All kinds of government consumption and investment are considered as Government spending (see fig 2 & 3). Though, it can be sub-categorized into government final consumption expenditure (acquisition of goods and services by the government for current use to directly satisfy individual or collective needs of the society), gross fixed capital formation (acquirement of goods and services for future benefits such as infrastructure investment, research spending) and transfer payments. Thus, through public expenditure, the government influences directly or indirectly production, consumption and distribution of the nation, helping towards the economic and social wellbeing of the society.

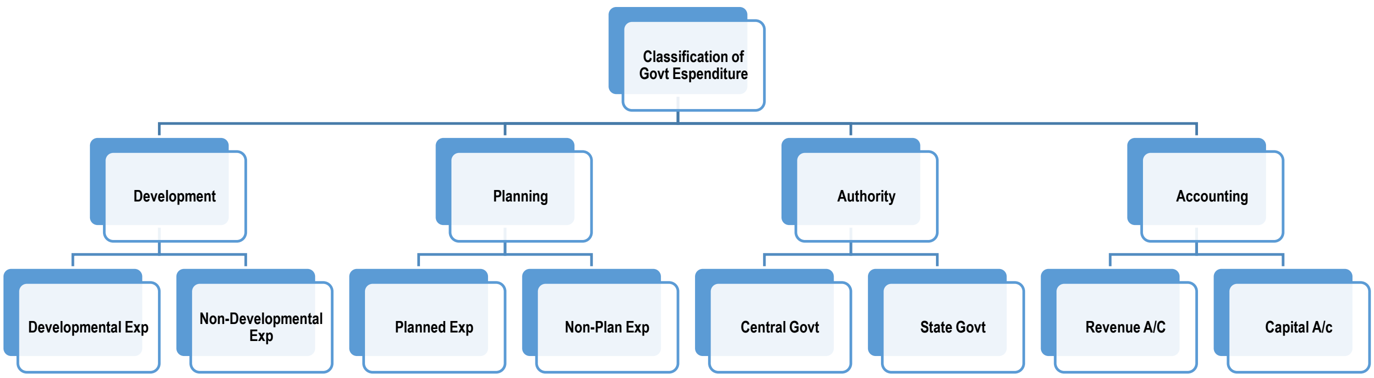

Fig 3 Classification of Public Expenditure on various parameters

Source: An Economic and Functional Classification of the Central Government Budged 2008-09, Ministry of Finance GOI

The combined public expenditure (centre and states) of India, since 1990-91 to 2011 has been consistently more than 30 percent of the GDP(see fig 4) calculated in dollar terms by IMF experts, however in terms of domestic currency it is approximately in between 27 percentage to 30 percentage of GDPmp . It implies build in expenditure parameters of state and central government and inability of theirs' to follow fiscal disciple to control expenditure beyond fiscal limits. During the first decade of the implementation of Rao-Manmohan development strategy government expenditure grew at an average rate of 34 percent per annum in nominal terms and . during seventeen years of 21st century (see table 1).

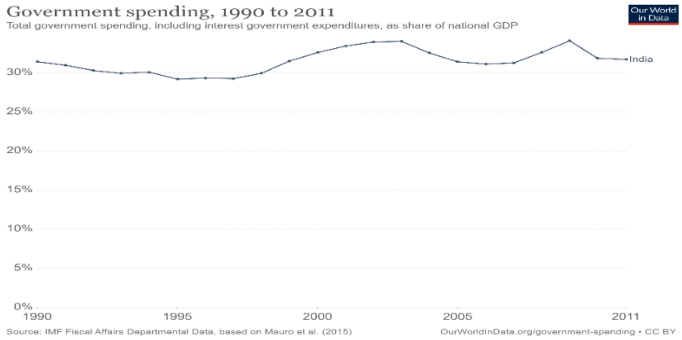

Fig 4 Combined (Centre & State) Government expenditure in India 1990-2011

Source: IMF digital library and online database

4. Macroeconomic parameter of India in 1990s and 2000s

The sound macroeconomic parameters of an economy are indicator of its good health and robust performance. Since the adoption of liberalisation, privatisation, and globalisation regime in 1991, Indian economy has performed well except a few intermittent years amid Asian and global financial crisis. The average growth rate in quarter century period (1990-2015) is more than 7 percent per annum a surprising for many who cracked joke for growth rate of India economy terming it 'Hindu growth rate' in pre reform era.

The gross saving and gross capital formation, the two important parameters for generation and mobilisation of resources for future consumption has risen significantly from 22 percent and 26 percent as a ratio of GDPmp in year 1990-91 to 33.4 percent and 34.7 percent respectively in year 2005-06, pointing to the stage of rapid capital formation and an increase in the productive capacity of the economy. However, it remained stagnant and soaring around 30 percent from year 2010-11 onwards.

Table 2 Macroeconomic parameters of India 1991-2020

Year	Gross Saving	Gross Capital Formation	Aggregate Demand (GDP_{MP}) Current Prices*	Gross Savings % of Aggregate demand (GDP_{MP})	Gross Capital formation % aggregate demand (GDP_{MP})
1990-91	134408	152604	586212	22.09	26.0
1995-96	289265	310045	1226725	23.6	25.3
2000-01	515545	528299	2177413	23.7	24.3
2005-06	1235151	1279754	3693369	33.4	34.7
2010-11	2621742	2841457	7784115	33.7	36.5
2015-16	4282259	4422659	13771874	31.1	32.1
2016-17	4648421	4741385	15362386	30.3	30.9
2017-18 (RE)	5216022	5526853	17095005	30.5	32.3

Source: Public finance statistics GOI various issues

* The value of respective years till 2010-11 is based on 2004-05 prices and later years is calculated on 2011-12 base prices RE- Revised Estimates PE- Provisional Estimates AE- Advance Estimates

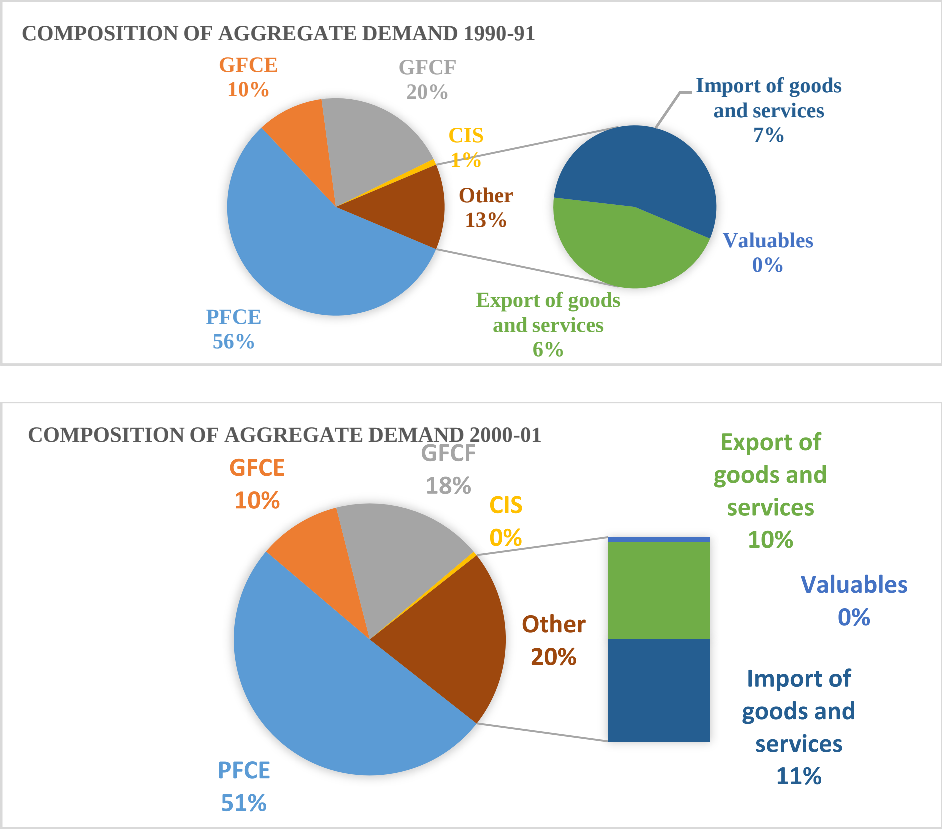

Fig 5 Composition of Aggregate Demand 1990-91 and 2000-01

Source: Public finance statistics of India, Ministry of Finance 2017-18 GOI

5. Recent developments and spark of hope amid global pandemic and health crisis

The unprecedented and unparalleled development of international affairs on the eve of year 2020 and COVID-19 induced lockdown of the Indian economy since March 2020 led downward trends in economic growth and probably first time in the economic history of India observed 24 percent decline in GDP in first quarter of financial year 2020-21, albeit future prospects of economy recovery has been brightened by recently released data which shows a moderate decline of -7.5 percent in second quarter due to fiscal initiative and gradual unlocking of the economy. The positive forecast of economic recovery for Indian economy by global body like IMF, ADB shows sooner recovery and back to track growth trajectory.

Conclusions

In post economic reform era government expenditure has played catalyst role through promoting private sector vis a vis complementary state induced expenditure with disciplined fiscal measures. The unswerving and prudent macroeconomic parameters reflect its robust economic performance and paradigm shift form low development trajectory to stage of sustained growth. Notes1 'Centre' means the Central Government and the Government of Union Territories,which do not have legislatures. Delhi, which was earlier included in Centre, has been includedin the States since 1993-94. 'State' means the State Governments and the Governments ofUnion Territories with legislature. General Government means Central Government and StateGovernments together. CGE- Central Government Expenditure, GFCE – Government Final Consumption Expenditure, GFCF- Gross Fixed Capital Formation, CIS- Change in Stock, PFCE-Private Final Consumption Expenditure

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