Trends in Government Expenditure

Enhancing the Quality of Life of Our People

K. P. Geethakrishnan

Freedom with Responsibility

Indian Liberal Group

The text of this publication is the Sixth Ambirajan Memorial Lecture delivered by Mr. K. P. Geethakrishnan, IAS (Retd.) in Chennai on March 30, 2007. The lecture was sponsored by the Institute for Economic Education, and the Public Expenditure Round Table, both of Chennai.

The views expressed in this publication are not necessarily those of the Institute for Economic Education, the Public Expenditure Round Table or the Indian Liberal Group.

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500/05/2007

Preface

Forwarding the text of the Sixth Ambirajan Memorial Lecture on 'Trends in Government Expenditure', delivered by him on March 30, 2007 in Chennai, Mr. K. P. Geethakrishnan in a covering note commented: "The Indian Liberal Group may not be willing to admit it openly; but if the social objectives set out in detail, in words, in ILG documents are reduced to hard numbers, these will not be much different from what I have projected."

After I had read through the lecture, I saw no conflict between what he had to say and the ILG's stated social objectives spelt out, for instance, in the ILG's "Liberal Budget 2007-2008 – Taking Reforms to the Poor." In the preface to that document we affirmed "...that the long term Liberal perspective may be to see India's emergence as a global power...But as Liberals our immediate concerns are entirely internal. If the reforms process translates itself into a better life for our people particularly those in rural India where70% of India live; if farmers are no longer compelled to commit suicide as a way out of their indebtedness; if we no longer have starvation deaths; if every Indian enjoys medical care comparable with the best that the world has to offer; if our education is not only universal but of high quality; and if we can boast of a world class infrastructure then we can say with some legitimacy that we are indeed on the road to becoming a world power."

Liberals realise that all this requires a great deal of money and therefore realistic enough to admit that these social sector tasks can only be tackled by the State, ideally, in partnership, wherever possible, with private initiative and enterprise. What Liberals are against is wasteful expenditure not expenditure that improves the quality of life of the poorest of the poor. "Dr. Ambirajan", as Mr. Geethakrishnan notes in his lecture, "looked at government expenditure, not as a mere accounting entity, but as a tool, the means, for enhancing the quality of life of the people. The lecture seeks to give shape to the vision of the compassionate economist." The ILG has outlined its social objectives; what Mr. Geethakrishnan has attempted is to point out how to get there. There may be differences of opinion on approach, even strategy, but these would be on matters of detail, not on the principle that man is the measure of all things.

Having said this, we are grateful to the Institute of Economic Education and the Public Expenditure Round Table for giving us permission to publish this Lecture to reach a wider audience.

S. V. Raju,
National Coordinator,
Indian Liberal Group

Mumbai, April 30, 2007

Dr. S. AMBIRAJAN

A Compassionate Economist

Dr. Srinivasa Ambirajan (1936-2001) belonged to a family of scholars. His father Prof. K.R. Srinivasa Iyengar was a renowned scholar and poet and had a distinguished career as a Professor of English and as Vice-Chancellor of Andhra University.

After schooling and a Ph.D. in Economics from the Andhra University Dr.Ambirajan continued his studies at the University of Manchester, where he held the Bank of England Houblon-Norman Research fellowship and the Hallsworth Research fellowship with distinction, taking another doctoral degree in the process.

He began his teaching career with the University of Queensland, Brisbane moving over to the University of New South Wales, Sydney where he served for 15 years. On returning to India in 1981, he joined the Humanities and Social Science Department, Indian Institute of Technology, Chennai from where he retired in 1996 after distinguished service including a stint as the Head of the Department. After retirement he was a visiting professor with the Madras School of Economics, till his death in February 2001.

Dr. Ambirajan earned the reputation as a superb teacher, who could explain complicated economic theory and political economy with effortless ease. His forte was Economic History, though his interest and specialization extended to areas of Economic Development and Public Finance.

Dr. Ambirajan was a learned professor, who never ceased to learn. His writings began with research papers like 'Japanese Economic Recovery and its lessons for India'; 'McCullochon India'; 'Laissez-faire in Madras' and 'Political Economy and Indian Economic Policy in the 19th Century'.

Dr. Ambirajan's first book 'A Grammar of Indian Planning'

warned boldly that the whole exercise of Indian planning "from above" was fraught with several uncertainties and cautioned the planners, that without checks and safety valves planning might become "a fruitless piece of adventurism repeated myopically down the decades".

Then followed his book 'Malthus and Classical Economics', 'The Taxation of Corporate Income in India', wherein he called for the promotion of joint stock companies in the private and public sectors in India.

His 'Classical Political Economy and British Policy in India', critically examined the effects of the policies of the British Government in India. The book was hailed as "a highly proficient and conscientious piece of scholarship." 'Political Economy and Monetary Management India 1766-1914' was another Ambirajan masterpiece, where he made insightful remarks regarding the manner in which India's monetary policy was inspired by the ideas of Sir James Steuart, Alfred Marshall and J M Keynes. Speaking of economists, he asked the question whether they really had the power they are supposed to be invested with in making or marring policies. He held the view that the ideas of economists should coincide with other interests to have any impact.

Dr. Ambirajan's articles on current economic issues in *The Hindu* and the *Economic Times* were later published as a book 'Good People, Bad Times'. In all these writings he believed that "public discourse on policy should be defined by sobriety, facts and reason, and not by emotion and abuse".

Dr. Ambirajan was equally at ease with Tamil, Telugu, Kannada and Sanskrit. He would come out with allusive quotations from any of these languages, as the occasion demanded lacing his lectures and writings with mild humour, without hurting anyone.

[Abridged from Mr. Geethakrishnan's introductory remarks at the Sixth Dr. Ambirajan Memorial Lecture.]

Mr. K. P. Geethakrishnan

K. P. Geethakrishnan, born 12 November 1935. B.Sc.(Hons) from Presidency College, Chennai (1952-55). Member of the Indian Administrative Service, Tamil Nadu Cadre from 1958 to 1993.

A major part of his career was with the Finance Department of the Government of Tamil Nadu and the Finance Ministry of the Government of India. He retired as Finance Secretary, Government of India in 1993. After retirement he was Executive Director, International Monetary Fund from March 1993 to July 1996 and Chairman of the Expenditure Reforms Commission, Government of India in 2000-2001.

Mr. Geethakrishnan is an active participant in the Indian Liberal Group's Liberal Budget formulation exercises.

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The two page brief on Dr. S. Ambirajan refers to him as a compassionate economist, a person of great intellectual attainments both as a teacher and as a researcher, coupled with a humane, helpful approach towards all men and matters. He has written books, monographs, articles and papers on diverse aspects of economics, including Economic History, Economic Development and Public Finance.

In the late nineties, I had the privilege and pleasure of participating along with Dr. Ambirajan in several interactions on Economic Reforms and on the Budget organised by the Public Expenditure Round Table, the Institute of Economic Education and others. At these meetings I found Dr. Ambirajan's vast knowledge in the field of economics, and my experience as a Government official, that too mostly in the Finance Ministry, overlapped albeit in a small way, in one area namely Government Expenditure Management.

In the years immediately after the launch of economic reforms, the focus of most interactions was on fiscal consolidation with most speakers taking a uni-dimensional view equating fiscal consolidation with expenditure compression. This approach is seen even now though in a slightly muted manner. The reasons are not far to seek. Both anecdotal evidence and hard budget numbers support such an approach. In every Government office one sees a large number of officials either talking or wandering here and there in an apparently aimless manner. Every year governments at the Centre and the states announce new freebies and subsidies, which to those who are not the beneficiaries, appear as sheer wasteful expenditure of hard earned money paid as taxes. A common excuse among those who earn a lot but pay little as taxes is, 'why should we - it will be frittered away on wasteful expenditure and absorbed by corruption'.

Expenditure Compression Can Be Counter-productive

Then there are the hard numbers. The number of officials in the Central and state governments and their public sector undertakings exceeds 20 million and their pay packet is a mind boggling Rs.300,000 crores. This does not include the expenditure on cars, housing and medical facilities provided to them. The total subsidy bill was placed in two studies in the mid-nineties at 15% of the GDP i.e. over Rs.300,000 crores then. To top this, is the assessment of a former Prime Minister that, of every Re.1 spent on a programme only 16 paise reaches the beneficiary – the common man. The rest (84%) is absorbed in transmission!

In the face of such evidence - anecdotal and the hard numbers, and given the high levels of fiscal deficits, it required a brave person to plead for more expenditure. Dr. Ambirajan was this exception. Ever compassionate, he used to point out gently that there was scope for weeding out wasteful expenditure and making the system more efficient, thus getting more value for money spent. He argued that expenditure compressionists could have the day in the short term, but government expenditure as a proportion of GDP should go up sharply in the long term, as the coverage of programmes for improving the quality of life of the people were made universal and the quality of services improved to a level that the country could be proud of. In private discussions Dr. Ambirajan pointed out that in Western Europeans countries government expenditure trends over a 150 year period have exhibited a increasing trend going up to 45% of GDP; with health, education, social security and public investments accounting for a good part of it.

Thanks to Dr. Ambirajan I have had occasion to study the experience of developed countries which I would like to share with you. I will then place before you the details of government expenditure trends in our country. From a comparison of both sets of numbers, conclusions to be drawn about the future trends in government expenditure in India, appear to be quite obvious.

Expenditure Trends in Developed Countries

There are numerous studies on the trends in government expenditure in the developed countries. The list of countries studied include Japan, Australia, New Zealand, Western European countries including the UK, the USA and Canada. The data is available for the period 1870 to 1990-95. Prior to 1937 there is a lack of uniformity in the definitions of specific expenditure items as also in the reference years. Moreover in some countries the data pertains only to the gentral government for the earlier years, while in most the expenditure details are for the 'General Government' – the central government, the State/regional formations and locals bodies. Thus, while making comparisons one has to be aware of these limitations and not get carried away by the numbers which are given up to the first decimal. The numbers are only approximations. The data is presented in *Appendix-I*.

The average total expenditure, for these developed countries around 1870, was 10.8% of the GDP. In seven of these countries (Australia, France, Netherlands, Norway, Spain, Sweden and the USA) for which break up details are available, the direct consumption expenditure of the government, or what is termed the 'Government Real Expenditure', was 4.6% of the GDP and this accounted for one half to two thirds of the total expenditure in many of these countries. This covers government establishments, police, defence and public investments including public schools, etc. Defence and public investments usually accounted for the bulk of government real expenditure. Australia led with a public investment of 6.9%, a lead it maintained for the next 70 years. During this period the expenditure on transfers and subsidies i.e. on social overheads was minimal and the little that was spent, was on education.

The total expenditure increased at a slow pace over the next 40 years, reaching 13.1% of GDP in 1913. Expenditure on education had increased to 1.3% (with Germany leading with 2.7%). Health and pension also figured in the picture, with provisions of 0.3% and 0.4% respectively. The First World War and the run up to the Second World War witnessed a sharp increase in defence expenditure. By 1937, it was 9.9% of GDP in Italy, 9.6% in Germany and 5.3% each in Japan and the UK. The Great Depression led to a spurt in public spending in the USA and in many other countries. The total expenditure rose to 23.8% of GDP, with defence and public investment accounting for 3.7% and 3.8% respectively. However, the increase in the total expenditure figure in this 24-year period cannot be considered high, as it was partly due to the considerably depressed GDP figures because of the Great Depression. Though public welfare was now accepted as one of the prime areas for government intervention, the total subsidies and transfers stood at a modest 4.5% – education 2.1%, pensions 1.9% and health 0.4%.

The Impact of the Great Depression

Between 1937 and the 1960, the total expenditure rose by 4.2%, the entire increase being accounted for by public welfare measures. But then, the Great Depression and the resultant large scale unemployment and the Second World War and the need for large scale reconstruction, created an unprecedented clamour for activist expenditure policies coupled with rapid growth in the direct involvement of the Government in the economy. The forceful stance for bigger government involvement in the provision of goods and services and the intellectual belief in a positive role for the State and its power to carry out such a role came to be embedded in the legal and institutional framework for countries' policy-making. In the wake of the Great Depreciation, the Supreme Court of the USA ruled that the power of the Congress to authorise expenditure for

public purposes could not be limited by the direct grants of the legislative powers found in the Constitution. Post-Second World War, many European countries tended to accept welfare rights as Constitutional Rights. Legal provisions were made for strong interventionist polices in the Constitution (Germany and Switzerland) or through their legislature (the United States of America).

Increasing Subsidies

Between 1960 and 1980 there was a sharp increase in subsidies and transfers from 9.7% to 21.4%, resulting in a corresponding increase in the total expenditure from 28% to 41.9%. Education and health reached 5.8% each, while pensions rose to 8.4%. The total outgo on such welfare activities was much above the average for Netherlands (38.5%) Sweden (30.4%) Belgium (30.0%) and Norway (27.0%).

Rising Fiscal Deficits

The sharp increase in total expenditure – reaching 60% in Sweden and a little below 50% each in Australia, Germany and France resulted in worsening fiscal deficits in many countries. On an average it exceeded 3% of GDP for the developed countries; Ireland had a deficit of 12% and Belgium and Italy were close to 10%. Scepticism about the proper role of the State and many of its activities grew. The ability of the government to allocate resources efficiently, to redistribute these in a well targeted manner and to stabilise the economy in the event of a crisis was questioned. The disincentive effects of high levels of taxation required for supporting such large public welfare expenditure and the (resultant) growth of underground economies were heatedly debated. At a political level, the emergence of Margaret Thatcher as Prime Minister of the UK and Ronald Regan as the President of the USA, both votaries of smaller government led to serious questions being raised about excessive government spending and costly welfare measures. A case was made for privatising some of the welfare programmes.

Notwithstanding the strong case made by economists and political leaders in many countries against governments playing a large role in the economy and in the provision of welfare measures, the total expenditure and the expenditure on subsidies and transfers continued to grow between 1980 and 1995, albeit some what slowly. This can be ascribed to a number of factors - the democratic process and the need to woo the voters, the tyranny of past commitments and numerous vested interests created in the earlier five decades, etc. The total expenditure increased to an average of 45% (1996) while the expenditure on health, education and social security increased to 6.4%, 6.1% and 9.6% respectively. Among these countries the USA has the lowest expenditure levels - total expenditure 32.4%, transfers and subsidies 13.11% and education 1.3%.

Financing Public Spending

Between 1870 and 1960, except in times of war, the expenditure was largely financed by tax revenues. While in the earlier decades indirect taxes accounted for bulk of the revenues, in recent years direct tax collections are more or less on par with indirect tax revenues. The increase in pension outgo is now more than offset by social security levies which increased to 12.1% of GDP in 1995. As tax collections, in spite of new levies and marginal levies exceeding 50% in many countries, could not rise at the same pace as the increase in social welfare expenditure, governments resorted to deficit financing, this in turn leading to higher public debt, even without a war!

In the foregoing paragraphs I have drawn extensively from the book "*Public Spending in the 20th Century - A Global Perspective*" - by Vito Tanzi and Lindger Shucknecht. The authors have argued that for the reasons indicated earlier, the total expenditure in the developed countries may ultimately settle between 25% to 35%. However, I feel that the ground reality, the no holds barred political jostling for power in all democracies, be it in a developed country or in an emerging economy and the vice-like hold of vested interests, would stymie all efforts at rationalising government spending

and bring it to a lower level. The merits or the need for welfare measures may not even figure in election debates. In a democracy, the have-nots being the majority, the pressure will always be for more and more direct government support in areas like health, education and social security. In the normal course, expenditure on these items can only increase steadily with time. What constraints this growth is not so much economic arguments against Big Government, but the social cost, the excessive burden of taxation (and borrowing) required for financing these expenditures. This results in the total expenditure flattening out or at best registering a small fall, but not any sharp reduction.

Public Expenditure in India

When India attained independence illiteracy was over 80%; life expectancy at birth well below 40 years; infant mortality rate 146 per 1000 live births; and proportion of people below the poverty line well above 60%. The total Central Government expenditure in 1951 was understandably quite low at 5% of the GDP. There is thus not much purpose in looking at Government expenditure allocation for sectors like health, education, etc. Moreover, with the adoption of a socialistic model of economic development, Government started development work in all areas of the economy, directly through the state governments and their departmental agencies and public sector undertakings. Thus, while in the developed countries one looked at only the government expenditure in three areas - health, education and pensions as directly benefiting the individual members of the population, in India one has perhaps to look at the entire plan/development expenditure, as each sector contributes in some measure to the well being and better quality of life of the individual.

The one limitation to this approach is the non-availability of data, particularly on a comparable basis, for all sectors, for all formations, particularly for the earlier decades. In the subsequent paragraphs an attempt is made therefore, to first examine the trends in Central Government expenditure since the launching of economic reforms and then superimpose the data for all states for the year 2006-2007 for a total picture. As the coverage of the public sector and departmental undertakings is limited, even this becomes a somewhat incomplete picture.

Changes in Economic Policy

In 1985 the first major step was taken to break out of the essentially inward looking economic model followed till then. The entertainment, electronics and telecommunication sectors were opened up to large scale import of CKD & SKD components and the finished products catered to the pent-up domestic demand. This had two major consequences. The GDP growth rate went up to 5% per annum compared to the 3.5% of the earlier periods and new employment opportunities were created in large numbers and that too for raw graduates. The downside of this import-led spurt in domestic consumption was that the meagre foreign exchange reserves were quickly depleted and the country was heading for a balance of payments crisis by 1990.

Economic Reforms and Controlling Expenditure

It was in response to the impending collapse in the balance of payments that comprehensive economic reforms were launched in mid-1991. While immediate collapse was averted with IMF support, as a permanent measure the global competitiveness of the economy and ability to attract foreign exchange earnings had to be improved. Towards this end the industrial licensing system was substantially dismantled and trade, tariff and tax reforms undertaken. As the sharp downward revision of tax rates was expected to lead to a fall in tax to GDP ratio in the short term and as fiscal deficit was at an unacceptably high level, with tremendous inflationary pressures, expenditure compression became a key element of the reforms package. As these measures were under contemplation even in 1990-91 and several expenditure compression measures undertaken in

that year itself, the year 1989-90 becomes the ideal starting point for studying the trends in government expenditure in India, in the economic reforms era.

The major items of Central Government expenditure in the years 1989-90, 1991-92, 1996-97, 2006-07 (BE & RE) and 2007-08 BE are set out in absolute terms in *Appendix-II* and as percentages of GDP in *Appendix III*. As will be seen from the data in *Appendix-II*, the expenditure compression was quite sharp in the first phase of seven years 1989-90 to 1996-97, dropping to 4% of the GDP. The reduction was as much as 23% of the total expenditure in 1989-90. Even with such a large fall in expenditure, the fiscal deficit came down only by 2% – from 6.15% to 4.10%, as during this period the interest outgo went up by 1% due to the freeing of the interest regime in the banking sector and consequent increase in the cost of borrowing for the Government – and a fall of nearly 1% in gross tax receipts due to the sharp reduction in tax rates. Gross tax receipts continued to fall till 2001-2002 when it reached 8.23% of the GDP.

The expenditure compression was across the board, affecting both the plan and the non-plan side. The worst affected was Plan Capital Expenditure i.e. Government public investment. The logic was simple. New starts could be postponed and on-going projects staggered! Subsidies were also hard hit, with many being frozen in nominal terms and not allowed much real increase. The Plan Revenue component was also not spared. Defence expenditure was also cut. The intention was clear; given the overwhelming need for containing fiscal deficit, and that too when the tax to GDP ratio was going down, expenditure compression was the only way out.

After a Decade of Economic Reforms

This picture has changed dramatically in the last ten years. With good economic growth rates and widening of the tax base, gross tax collection has gone up by over 3.5% since 2001-02 reaching

11.84% in BE 2007-2008. Interest outgo has started declining and at 3.43% in BE 2007-08 it is below the 1989-90 level. Defence and subsidy outgoes are also declining. Pensions outgo is going up but slowly. Police expenditure is steadily going up reflecting the increasing political and social tensions in the country. On the whole, the non plan expenditure is under control and may go down a bit every year. Reflecting the announcement of a slew of new, large initiatives for the betterment of weaker sections, rural areas and agriculture, the Plan Revenue component is steadily going up. But often it is a case of re-packaging old schemes and this is evident from the fact that even after several years of new '*Yojanas*' the total Plan Revenue expenditure is placed in BE 2007-08 at 4.43% compared to 5.66% in 1989-90! The Plan Capital expenditure component continues to be pushed down. At 0.92% (inclusive of 0.25% being the equivalent of loan support for state Plans, stopped since two years back) it is less than one fourth the 1989-90 level. To the extent that this reduction reflects the ability of the undertakings to raise moneys outside of Government support, it is good. If however, it is the result of the drive for reducing the fiscal deficit, it pushes down public investment and that is not good.

Thus, on the whole, the expenditure pattern can be said to have 'settled'. Plan expenditure can and will go up as efforts in areas like agriculture, health, education and infrastructure are strengthened; non-plan expenditure is under control and there is a steady increase in the tax to GDP ratio. All this would lead to a reduction in revenue deficit (target zero) and fiscal deficit (target 2%) in a few years time. Of the two Budget Estimates 2006-07 and 2007-08 the earlier one is taken as the reference point as the consolidated picture of state budgets is available only for 2006-07 BE (most states are yet to announce their 2007-08 budget) and it is by taking the states and Centre together that one gets a total picture.

For all the states and Centre taken together, the total expenditure provided in BE 2006-07, after netting out transfers was Rs.1,160,466

crores (Centre Rs.563,991 crores, minus non plan grants Rs.35,361 crore, minus plan grants Rs.36,293 crores, plus all states Rs.668,129 crores). This works out to 29.01% of the GDP. For education the total provision in BE 2006-07 for all states and Centre was Rs.120,277 crores (Centre Rs.24,155 crores and states Rs.96,122 crores) or 3.01% of the GDP. For health, the total provision was Rs.38,598 crores (Centre Rs.12,994 crores plus states Rs.25,504 crores) or 0.96% of the GDP. For pensions the total provision was Rs.69,137 crores (Centre Rs.21,312 crores plus states Rs.47,825 crores) or 1.73% of the GDP. The total public investment, if taken as equivalent to the plan capital expenditure and the internal and extra budgetary resources of the undertakings was around Rs.270,000 crores or 6.61% of the GDP. The gross tax revenues was Rs.752,693 crores, Rs.442153 for the Centre and Rs.310,540 for the states working out 1 to 18.79%.

Public Investments and Subsidies Excluded

One last item for comparison purposes is the 'Government Real Expenditure'. Here it would be appropriate to exclude public investments and subsidies which in India are not only large but also an integral part of Government's efforts for directly improving the quality of life of the people. This expenditure provision in BE 2006-07 for the Centre and states (i.e. non-plan, non-developed expenditure, minus subsidies and pensions) was 15.48% of GDP compared to 14.4% for the developed countries. If developed countries are considered by definition to be efficient, then there is some scope, though not much, for effecting economies in this area of expenditure in India.

Spending Wisely

A comparison of the General Government expenditure in India in 2006-07 (B.E.) with that of the developed countries in 1960, 1980 and 1995 throws up not only the areas of concern (for India) but also the lines on which corrective action need to be taken. The relevant numbers are set out below.

Percentage to G.D.P.

	India 2006-07 BE	Developed Countries 1960	1980	1995
Total Expenditure	29.01	28.0	41.9	45.0
Education	3.01	3.5	5.8	6.1
Health	0.96	2.4	5.8	6.4
Pension	1.73	4.5	8.4	9.6
Public Investments	6.61	3.8	3.5	2.9
Tax Receipts	18.93	23.1	27.1	28.3

Public investments in developed countries have shown a declining trend in the last 70 years, thanks to their private sector orientation. On the other hand, in India, the socialistic model of economy followed in the first four decades has led to a dominant position for the public sector in almost all areas of the economy. This is reflected in the high public investment level of 6.6% of the GDP. In all other areas, particularly in tax receipts, total expenditure, health and pensions the gap between India (BE 2006-07) and developed countries (1995) is so large as to drive one to despair. In fact India in 2006-07, lags behind even the 1960 levels of the developed countries in health, pensions and tax receipts.

Where Expenditure Increase is Needed

India has miles to go: in the adequate provision of infrastructure and civic amenities; achieving universal education; providing basic medical and health facilities to all; increasing investments in agriculture; reaching full coverage in the employment guarantee and poverty alleviation programmes; and in enlarging the safety net to cover all those who need it. All this will involve large additional expenditure, maybe even to the order of 10% of the GDP,

and the bulk of it has to be met by government. More importantly, many of the services now provided are merely 'shells', lacking quality: schools with teachers but no class rooms or playgrounds; rural dispensaries without medicines and sometimes, without doctors or nurses; police officials without the wherewithal or will to reach an accident/incident spot in time to provide relief and so on. Improving the quality of existing services will, in fact, be more costly and problematic, than extending the coverage.

Calculated Risk Justified

The question that arises is whether it is feasible to attempt to do all this, without jeopardising macro economic stability, particularly in the present context, when expenditure is at a high level in relation to low tax to GDP ratio leading to high fiscal deficit levels. The answer is clearly in the affirmative though the task is not an easy one.

Pensions Reforms

To start with one does not have to be frightened by the large gap between the expenditure and tax receipts in India and those in the developed countries. One major item is pension, which accounts for 9.6% of GDP in the developed countries. This is more than offset by social security payments of 12.1% by the future beneficiaries. In India, pension is limited to government officials and the out-go is almost fully from the government budget without any contribution from the beneficiaries. Pension reforms with beneficiaries having to make a contribution has been initiated. This has to be extended to all professionals in the private sector organised, as well as unorganised. This has to be done on the basis of a clear-cut programme and with a definite time table, say 7 to 10 years. As in the case of the developed countries, the outgo will be less than the inflows in the initial years, provided the funds are well managed. The coverage will increase with the expansion of the manufacturing and services sectors.

Infrastructure a Key State Responsibility

Government will have to continue to provide bulk of the funds required for infrastructure facilities and urban amenities. Even with the best of incentives, private sector will be slow in entering these areas involving low returns and long gestation periods. Luckily, the level of public investment in India is already high. This can be maintained for some years and allowed to come down as private sector efforts pick up steam. To this extent India can tolerate a higher level of fiscal deficit say 4 or 5% for the Central and state governments taken together, than the developed countries. All that is necessary is to keep revenue deficit at zero or near zero levels and ensure that investments are made wisely, keeping wasteful expenditure to a minimum.

Reviewing Some Subsidies

Tax to GDP ratio has to go up. Luckily with robust economic growth, tax to GDP ratio has been going up steadily in the last few years. This trend has to continue; tax base widened and compliance enforced, so that it becomes a habit. At the same time, tax and tariff reforms need to be persisted with so as to increase the global competitiveness of the economy. 32. The outgo on subsidies was estimated at 15% of the GDP in the mid-nineties in two studies. One part is the direct subsidy provided from the budget - like food subsidy, fertilizer subsidy, etc. and the other part is the revenue foregone on investments in roads, irrigation projects, health and educational facilities, etc. To the extent subsidies serve as social safety net they serve a useful purpose. But then, there is a case for examining each subsidy on merit and weeding out those which have out-lived their utility and to target better the remaining. With large sections of the population moving upwards to 'middle class' status every year, the need for targeting becomes even more urgent. May be, one could aim at a reduction of 1 % every year for the next five years. About one half of this may materialise in the form of reduced expenditure and the other half in increased non - tax revenues.

Incidentally, there has to be a conscious effort to increase non-tax revenues. In spite of large scale investments in projects and heavy lending to the states and to the public sector and departmental undertakings in the past, the total non-tax revenue in India in 2006-07 is 4%, that is the same level as for the developed countries!

Streamlining Delivery Systems

The last major element in this package is the 'transmission loss' placed at 84% by a former Prime Minister. While streamlining the delivery system and supervisory hierarchies would help reduce cost and improve efficiency, the real answer would lie in full transparency and involving local leaders and NGOs in social auditing of the programmes.

All five items – improving the quality of the services now being provided; increasing the coverage of these services to all those who require state support; better targeting of all subsidies; drastically reducing the 'transmission loss'; and stepping up the tax to GDP ratio, will have to be put across as a single package. It is by taking action on all fronts simultaneously that public acceptance of the individual elements can be enhanced. Clear, time bound action plans would have to be drawn in detail for each area, announced to the public at large and implemented under full public gaze. The objective should be to achieve a substantial improvement in the quality of life for most of population -at least 90% by the end of the 11th five year plan. This may involve total expenditure going up to about 33% of the GDP, financed by about 23% tax receipts, 6% non-tax revenues and 4% fiscal deficit. The outgo on pensions to be funded by contributions from future beneficiaries will build up slowly as the coverage increases. This outgo, as well as the receipts, will be over and above the expenditure and receipts figures projected here.

Government's Commitment to Social Welfare?

The developed countries registered a quantum leap in the coverage of public welfare measures in a period of just twenty years from 1960 to 1980. Given the 'Welfare and Development' orientation of Indian planning right from 1951, it should be possible for India to achieve comparable success in a much shorter period but there is a catch. As mentioned earlier, in the developed countries a case had been made out by 1960, at an intellectual as well as political level for a greater government role in providing welfare measures. In India, however, the focus in recent years has been on achieving high - even double digit - GDP growth rates, even as the expenditure compression measures launched in 1990-91 are continued. It is true that numerous measures are announced from time to time for increasing the coverage of welfare programmes. But then the implementation of these programmes leaves much to be desired. One does not see the same commitment to these programmes as for those measures that attract more foreign institutional investment, or secure higher growth rates in the manufacturing, IT and service sectors. A major attitude change is therefore called for in the 'powers that be' if the quality and coverage of the welfare programmes are to be improved quickly. Moreover, as the responsibility for implementation in areas like agriculture, poverty alleviation, education, health, etc. lies largely with the state Governments, it would be necessary to fully associate them right from the stage of planning and formulation of schemes in these sectors. It is such as approach that has helped in the successful implementation of the value added tax regime.

If I have chosen 'Government Expenditure Trends' as the topic for today's talk it is for a very definite reason. On the occasions that I had met Dr. S. Ambirajan, our interaction was mostly on this topic. Dr. Ambirajan looked at Government Expenditure, not as a mere accounting entity, but as a tool, the means, for enhancing the quality of life of the people. This lecture seeks to give shape to the vision of the 'Compassionate Economist'.

Appendix-I

Trends in General Government Expenditure Developed Countries

As proportion of GDP in percentage

	About 1870	1913	1937	1960	1980	Mid 1990's
Total Exp	10.8	13.1	23.8	28.0	41.9	45.0
Government Real Exp*	4.6	N.A.	11.4	12.6	17.9	17.3
	(1900)	(1920)				
Defence	3.7	3.4	2.5	2.0	4.0	2.4
Public Investment	2.0	2.8	3.8	3.2	3.5	2.9
Subsidies and Transfers	1.1	N.A.	4.5	9.7	21.4	23.2
Education	0.6	1.3	2.1	3.5	5.8	6.1
Health		0.3	0.4	2.4	5.8	6.4
	(1910)	(1930)				
Pensions	0.4	1.9	4.5	8.4	9.6	

(a) Defined as that part of the expenditure that is absorbed or used directly by Government i.e. on Government staff salaries, police, defence, interest, direct public investment on public education, etc.

N.A.: Not available

Source: Public Spending in the 20th Century - A Global Perspective by Vito Tanzi Ludgen Schuknecht

Appendix-II

Central Government Budgetary Transactions

Rs. Crores

	1989-90 *Actuals*	1991-92 *Actuals*	1996-97 *Actuals*	2006-07 *BE*	2006-07 *RE*	2007-08 *BE*
Total Expenditure	87166	105933	190336	563991	581637	640521*
Plan Expenditure	27520	30961	53534	172728	172730	205100
Of which						
Revenue	11979	15074	31635	143762	144584	174354
Capital	15541	15887	21899	28966	28146	30746
Non Plan Expenditure	59646	74972	136802	391263	408907	435421*
Of which						
Pensions	2327	2419	5094	21312	23225	23488
Subsidies	10474	12253	16364	46213	53463	54330
Interest	17757	26596	59478	139823	146192	158995
Defence	14416	16347	29505	89000	86000	97000
Police	1297	1849	3855	13682	13911	13939
Gross Tax Receipts	51636	67361	128762	442153	467848	548122*
Revenue Deficit	11914	16261	32654	84727	83436	71478
Fiscal Deficit	29890	30843	56062	148686	152328	150948
GDP at market prices 1993-94 Series	486179	653117	1368209	39530000	4100000	4630000

(a) Rs.40,000 crores relating to acquisition of shares in State Bank of India has been excluded as it is a book entry, offset by corresponding credit under capital receipts.

Source : Government of India Budget Documents and Economic Survey

Appendix-III

Central Government Budgetary Transactions

As proportion of GDP in percentage

Rs. Crores

	1989-90 *Actuals*	1991-92 *Actuals*	1996-97 *Actuals*	2006-2007 *RE*	2006-2007 *RE*	2007-2008 *BE*
Total Expenditure	17.93	16.22	13.91	14.27	14.19	13.83
Plan Expenditure	**5.66**	**4.74**	**3.91**	**4.37**	**4.21**	**4.43**
Of which						
Revenue	2.46	2.31	2.31	3.64	3.53	3.76
Capital	3.20	2.43	1.60	0.73	0.68	0.67
Non Plan Expenditure	**12.27**	**11.48**	**10.00**	**9.90**	**9.98**	**9.40**
Of which						
Pensions	0.48	0.37	0.37	0.54	0.49	0.51
Subsidies	2.15	1.88	1.20	1.17	1.30	1.17
Interest	3.65	4.07	4.35	3.54	3.57	3.43
Defence	2.97	2.50	2.14	2.25	2.10	2.10
Police	0.27	0.28	0.28	0.35	0.34	0.30
Gross Tax Receipts	10.62	10.31	9.41	11.19	11.41	11.84
Revenue Deficit	2.45	2.49	2.39	2.14	2.04	1.54
Fiscal Deficit	6.15	4.72	4.10	3.76	3.72	3.26
GDP at Market Prices (1993-94 Series)	486179	653117	1368209	3953000	4100000	4630000

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FREEDOM WITH RESPONSIBILITY

INDIAN LIBERAL GROUP

The INDIAN LIBERAL GROUP (ILG) is an organisation founded on 10 December 1965, by the late Minoo Masani, author and parliamentarian, to promote the liberal point of view on issues of the day and to educate the public on the concept of Liberalism so that it is understood and accepted by the people, not merely as a method of economic engineering but also as a philosophy of governance that promotes a civil society.

The ILG seeks to emphasise the fact that a market economy by itself does not ensure an open society; that a free economy and a free society are two sides of the same coin; and that a free and liberal democratic society alone will ensure a satisfying standard of life for the people.

The ILG firmly supports the economic reforms process, even while being critical of erroneous policies and decisions which give liberalisation a bad name. The ILG perceives its role not in negative terms of opposing the opponents of liberalisation but a positive one of promoting a free market system and strengthening a free society.

The primary objective of the ILG is to defend the fundamental liberal belief in the right of individuals to personal liberty, liberty of thought, expression, belief, faith and worship; the right of free association; the right to private property; the free choice of occupation; the right to information.

The INDIAN LIBERAL GROUP

- believes that the business of the State is government, not business.
- is opposed to any kind of monopoly.
- believes that technology is needed to promote human development and draws attention to the fact that the growth of Liberalism has been contemporaneous with the development of science and technology.
- affirms that active and participatory citizenship at all levels is essential for sustaining a liberal and democratic society.

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