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Public Expenditure and its classification

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Abstract: ***Government spending which also refers to as public expenditure indicates those expenses which are taken up by central,state and local governments of a country for its own maintenance and to satisfy the collective social wants of the people such as pension,infrastructure etc. Public expenditure is needed to promote rapid economic growth, to maximise social welfare, for equitable distribution of income,balanced regional growth,trade and commerce, full employment and to build social economic overheads e.g. roadways, railways, power etc. Maintenance of army, police force, law and order, development of industries, transport, communication, provision for public health etc., are the main objectives of public expenditure in modern world. This paper tells us about the concept of public expenditure. It also sheds light on how fiscal policy works. This paper evaluates about the importance of fiscal policy and classified public expenditure.***

Keywords: ***public expenditure, fiscal policy, monetary policy.***

Introduction

With the changing times India has moved from Nehruvian type of socialistic system to more and more mixed economy type of framework. Despite it, the role of fiscal policy and public expenditure has remained significant. In the era of globalisation, world has become like a global village because of increased connectivity and interdependence. And in the resultant competition and co-operation among nations, role of individual governments has taken an altogether new dimension. Traditionally government comes ahead to protect the country from foreign aggression, to promote economic growth, increase the efficiency of domestic sector and to increase the welfare of public.

Two dominant policies, used in various combinations to regulate a country's economic goals are

- Fiscal policy
- Monetary policy

Fiscal policy is the instrument by which a government regulate its expenditure and tax rates to observe and impact a nation's economy. Fiscal policy can also be used to stabilize an economy during the period of business cycles. It works through public expenditure, taxation and public debt, which further influenced aggregate demand, savings and investment in the economy and the distribution of income. Fiscal policy can be categorised into following types:

Expansionary fiscal policy:

When government want to increase the level of aggregate demand ,it cuts the tax rates and increases its spending. Because of the lower tax rate consumers disposable income increases and they spend more. But the lower tax rate decreases government revenue and as spending increased government will need to increase borrowing because of the budget deficit.

Deflationary fiscal policy:

When government has to cut down disposable income in consumers' hand to decrease the level of aggregate demand, it increases tax rates and reduces its spending also. Higher tax rates improve government budget deficit. This is known as deflationary fiscal policy.

Fiscal policy works with its various tools such as budget, taxation, public expenditure and public debt. These instruments help the public authority to go a long way in maintaining full employment in the absence of inflationary and deflationary forces. Among these instruments taxation and public expenditure are more effective for changing the level of disposable income, consumption and investment.

Fiscal policy plays a very important role to foster economic development and stability of underdeveloped countries. It can be explained by following points:

To mobilize resources:

One of the most important works of fiscal policy in underdeveloped countries is to deploy resources in public and private sectors. Because of low rate of savings, the national income and per capita income is also found to be at a low level. In such a situation, governments of underdeveloped countries enforce savings to increase the rate of investment and capital formation which consecutively speed up the economic development. Lack of foreign capital is also a big challenge for these countries. To overcome this problem it is necessary to increase saving ratio and to cut the conspicuous consumption. Progressive taxation, ban on manufacture of luxury goods etc. are other measures which help in deploying the resources and in equitable distribution of wealth.

To accelerate the rate of growth:

By increasing investment rate in public and private sectors fiscal policy helps to elevate the growth rate. Forachieving balanced growth in different sectors and to avoid the adverse effect on consumption, production and distribution of wealth combined use of fiscal policy tools like taxation, public borrowings, deficit financing etc. is needed.

To encourage socially optimal investment:

Fiscal policy controls unproductive and wasteful investment and stimulate investment into productive channels like transportation, communication, education, health etc., which are socially and economically desirable.

Inducement to investment and capital formation:

Fiscal policy supports new industries and instigates modern techniques in private sector on one side and on the other side it invests in strategic industries and services of public utility. Thus it increases social marginal productivity by investing in social and economic overheads and further it improves the marginal productivity of private investment.

To increase employment opportunities:

Unemployment is among the biggest challenges of an underdeveloped country. Because population growth is very high in these countries, fiscal policy aims to raise employment opportunities.

- Cyclical unemployment and fiscal policy: External factors in underdeveloped countries caused cyclical unemployment. When Demand for the products of underdeveloped countries falls in international market because of cyclical depression, then it increases unemployment in those industries which produces this product. To curb this unemployment fiscal policy can work towards the setting up of new industries and to develop agriculture. Furthermore, tax concessions, subsidies should etc., are the tools which can be utilised to control this unemployment.

- Disguised unemployment and fiscal policy: Underdeveloped countries faced the problem of disguised unemployment mainly in agriculture sector. By increasing the rate of capital formation this unemployment can be removed.

Promotion of economic stability:

Underdeveloped countries face condition of economic instability due to shortage of effective demand in short run or because of world market fluctuations. These countries mainly export primary products which has less elastic demand. But import capital goods and manufacturing goods, having a more elastic demand. Underdeveloped countries cannot take benefits neither when prices of exports fall, nor in the condition of price rise. A fall in price makes terms of trade unfavourable and decline in foreign exchange earnings due to their less productive capacity. If prices rise in international market, it increases export earnings but this increased earning move them towards unproductive expenditure. Fiscal policy can play a very important role to offset the effects of price fluctuations. During boom, to discourage conspicuous consumption heavy import duties can be imposed, and export duties to counteract the windfall gains.

To check inflationary tendencies:

Differences between demand and supply of real resources give rise to inflationary pressures in underdeveloped countries on the path of economic development. Structural rigidities of the economic system, market imperfections and pressures for wages etc., prevent supply to increase and this leads to increase in prices. Fiscal policy can help to control it by imposing expenditure tax, more taxes on rentier class, deploy resources through public debt, encouraging saving habits etc.

1.1

Public expenditure:

If we take a look at economic theory, classical economists believed in laissez faire policy. According to classical economists market mechanism is the best and government need not interfere so much in an economy. Government should limit itself to protect the country from foreign aggression, to maintain internal peace and order and to accomplish public development works. Expect these three functions all works performed by state is wasteful and unproductive.

In contrast, fiscalists like Keynes (1936) strongly supported role of government in reviving an economy by generating effective demand. Keynes supported deficit budgeting, giving the argument that it would help in creating effective demand in the economy. The Keynesian view envisaged that an increase in autonomous government expenditure, whether investment or consumption, financed by borrowing would cause output to expand through a multiplier process.

Another line of thought supports public expenditure by justifying its need for underdeveloped countries where vicious circle of poverty (as predicted by Nurkse, 1962) continues. To break this vicious circle and move towards self sustaining growth path, large amount of initial investment is necessary, which should be induced by the government.

1. 2:

Classification of Public Expenditure:

Public expenditure has been classified in different ways by different economists. The major types of public expenditure are discussed below:

Functional classification:

Adam Smith divided public expenditure into three parts according to functions:

a. Protective Functions: Expenditure on police,military,court,protection against social disease comes under the protective functions.
b. Commercial functions: Commercial functions include setting of commercial establishment under state control.

c. Development Functions: Functions which are related to the development of mankind like public recreation, education, infrastructure development like irrigation, forestry etc. are development functions.

Budget expenditure:

Budget expenditure can be categorised into two types:

a. Revenue expenditure: Expenditure which neither creates any asset nor declines any liability is revenue expenditure. Expenditure on pensions, payment of salaries, interest, grants to state etc. are revenue expenditure. This expenditure is recurring in nature.
b. Capital expenditure: This expenditure is non-recurring in nature. It either creates any asset or reduces any liability e.g. repayment of borrowings, loans to states and union territories, purchase of machinery etc.

Transfer and non-transfer expenditure:

Pigou classified expenditure into these two types:

a. Transfer expenditure: By exposing this kind of expenditure government gets nothing in return. This expenditure increases welfare of people and redistributes the money income within the society e.g. national old age pension schemes, subsidies, interest payment etc.
b. Non-Transfer expenditure: Internal law and order, defence, public administration, economic infrastructure are such type of expenditure which increases output directly or indirectly. These are called non-transfer expenditure.

Productive and non-productive expenditure:

Classical economists divided expenditure on the basis of productive capacity:

a. Productive expenditure: Productive expenditure creates productive asset and brings income to government. Expenditure on infrastructure development,public enterprises etc. are productive expenditure.
b. Unproductive expenditure: Unproductive expenditure includes that expenditure of government which do not create any productive asset and government does not get anything in return e.g. defence, public administration, interest payment.

Development and Non-Development expenditure:

Modern economists classified expenditure in development and non -development expenditure.

(a) Development expenditure: This expenditure is like productive expenditure because all expenditures that upgrade economic growth and development are development expenditure.

(b) Non-Development expenditure: Unproductive expenditures are non –development expenditure.

Grants and Purchase price: Hugh Dalton classified expenditure into two:

(a) Grants: Payments made by public authority like old age pension, subsidies, social insurance etc.for which government don't receive any goods or services in return are called grants.

(b) Purchase price: For this type of expenditure government receives some services or goods in return e.g. salaries to government employees,purchase of consumption and capital goods.

Dalton further classified public expenditure as following:

a. Expenditure on political executives

b. Administrative expenditure

c. Security expenditure

d. Expenditure on administration of justice

e. Developmental expenditure

f. Social expenditure

g. Public debt charges

Classification according to Benefits: On benefit basis expenditure can be categorised into three parts:

a. Common Benefits to all: Expenditures that provide benefits to all e.g. education, public health,law and order.
b. Special Benefits to all: Government provides some special benefits to all the people like community welfare, administration of justice etc.
c. Special benefits to some: Old age pension,unemployment benefits etc. are expenditure that provide special benefits to needy and also add to general welfare.

Conclusion:

This Paper throw light on the importance of fiscal policy. Fiscal policy helps the economy to come out the unfavourable situations. The broad classification of public expenditure helps to understand about productive and unproductive public expenditure and the usefulness.

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