27. PUBLIC EXPENDITURE.

Meaning of public expenditure: Public expenditure refers to the expenses incurred by the government for the maintainance of the government and to preserve the welfare of the society as a whole.

28. Public expenditure vs Private expenditure.

(i) Public expenditure is not motivated by profit whereas private expenditure is strictly based on the motto of maximum profit.

(ii) Public expenditure is dependent directly on the state revenues and the private expenditure is directly dependent on individual's income.

(iii) Public expenditure is more elastic than private expenditure

(iv) Public expenditure is made for social benefit like education, relief to the poor, public health etc, while private expenditure is limited to person level.

(v) Public expenditure is influenced by various politically motivated and social aspects while there is no such consideration on private expenditure

29. Aims and objectives of public expenditure

The aim of public expenditure is —

(i) To maximise economic and social welfare.
(ii) To control the depressionary tendency in the market economy.
(iii) To optimise the level of investment to maintain full employment with growth.

(iv) To accelerate the tempo of economic development by making infrastructures and increasing capital formation for further augmenting.

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(iii)

Classification of public expenditure.

It implies the systematic arrangement of various kinds of state outlays on some scientific and economic basis so that we may be able to know the effects and nature of each kind of expenditure with other. Hence, the classification of public expenditure is important for clear understanding the nature and effects of various kinds of public expenditure

Various classification of public expenditure

(A) Classification on the basis of benefit

On the basis of benefit, public expenditure was classified by Cohn and Plehn into four parts as—

i) Public expenditure which confers special benefits to certain people. Eg— public expenditure of justice, public expenditure on police protection.

(ii) Public expenditure which benefits equally to all. eg— transport, defence.

(iii) Public expenditure benefiting people and entire community as well. Eg— unemployment relief, old age pension

(iv) Public expenditure that specially benefit some individuals. eg— subsidies given to particular industry.

(B) Classification on the basis of function.

Adam Smith classified public expenditure according to the functions of the government as

(i) Protective expenditure: It includes expenditure on the purchase of arms and ammunations, defence, police, administration of justice and jails.

(ii) Commercial expenditure: It consists of expenditure incurred on the commercial activities, rail, roads, highways etc.

(iii) Development expenditure : It consist of expenditure made on providing education, health, public utility facilities to the community etc.

Criticism/Limitations.

It is not possible to say that a certain expenditure is protective but not developmental, another commercial and not developmental.

(C) Classification on the basis of revenue

On the basis of revenue Nicholoson has divided public expenditure into three heads :-

(i) Expenditure without direct return of revenue. eg- poor relief.

(ii) Expenditure without direct return of revenue but with indirect return to revenue.

eg- expenditure on education.

(iii) Expenditure with full return or even profit

eg- postal service, gas service etc.

Limitations : The classification is however onesided. The main purpose is not to yield revenue but to confer benefits to the community. The theory cannot be regarded as sound and perfect classification.

(D) Mill's classification.

J.S. Mill classified public expenditure into two classes -

(i) Obligatory expenditure : It refers to those expenditures which the state must incur. eg- defence expenditure.

(ii) Optional expenditure : It refers to those which state may or may not spend. They are expenditures on education, agriculture, industries etc.

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E) Classification on the basis of importance.

F. Shirras divided public expenditure into primary expenditure and secondary expenditure. Primary expenditure includes all expenditures of government which the government are obliged to undertake. Eg- defence, law and order, the payments of debts. All other expenditure after achieving this limit would be secondary expenditure.

Limitations : This classification was severly criticised because the terms primary and secondary have no scientifically fixed meaning.

(F) Dalton's classifications.

On the basis of whether or not the government gets on service in return of the expenditure, Hugh Dalton classified public expenditure into two categories - grants and purchase price.

When the state spends money and gets in return some services on communities called purchase price.

Eg- salaries on government employees, price paid on purchasing furniture.

On the other hand, when the government spends money and doesnot get any commodity or service in return, the expenditure is known as grants

Dalton also distinguishes between direct and indirect grants. According to him direct grants are those, the whole benefit of which accrues to the person to whom the grants are made.

Eg- old age pension.

On the other hand indirect grants are those where the whole are part of its benefit passed on to others.

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Unemployment allowance—Japan.

(G) ROSHER'S CLASSIFICATION.

Rosher classifies public expenditure into three categories.
(i) Necessary (ii) Useful and (iii) Superflorous.

Necessary expenditure is that which the state has to incur and which cannot be postponed. eg- defence exp.

Useful expenditure is that which is desirable but can be postponed. eg- welfare exp.

Superflorous expenditure is that which the state may or may not incur. eg- unemployment allowance.

Limitation : The expenditures incurred by the state are changing with the change in activities and responsibilities of the state. The expenditure which once was regarded as superflorous may now be regarded as necessary and useful for the state

The expenditure which is necessary is also useful and the expenditure which is not useful is also not necessary

** (H) PIGOU'S CLASSIFICATION

Pigou has classified public expenditure into transferable expenditure and non-transferable expenditure.

Transferable expenditure : Transferable public expenditure implied to purchase current national resource service. For eg- expenditure made on the payment of interest on government debt, pensions, sickness, benefit etc. It doesnot give rise to any income or output.

Non-transferable expenditure : An expenditure is said to be non-transferable public expenditure when it takes the form of money payment made to people either greatuitously or for the purchase of existing property rights. It always implies the actual using of commodities or services. For eg- expenditure incurred on maintainance and building of the armed, naval and air forces, civil services educational services, post office etc.

Limitation: Pigou's classification is suffered from vagueness as there is no clear cut distinction between transferable and non-transferable public expenditure.

I) MEHTA'S CLASSIFICATION.

Mehta classified public expenditure into two categories - (i) Constant expenditure and (ii) Variable expenditure.

Constant expenditure is that the amount of which doesnot depend upon the extent of the use by the people in who interest it is incurred. For eg- defence expenditure. As this expenditures are incurred irrespective of the number of people using the services

On the other hand, variable expenditure is that which increases with every increase in the use of public services by the people for whose benefit it is incurred. For eg- Postal service.

Limitation: In Mehta's classification, the basis of classification is cost and not benefit. This classification has been criticised by saying that it is defective as it assumes that state can incur unproductive expenditure also.

J) ECONOMIC classification.

According to this classification public expenditure is divided into revenue expenditure and capital expenditure

Revenue expenditure includes all current expenditure on administration, defence and public-commercial undertakings like railways, post and telegraphs, grants-in-aid etc.

Capital expenditure consist all capital transactions including defence and capital transactions of public commercial undertakings capital expenditure is further sub-divided into two heads:-

(a) Gross Fixed Capital (b) Increase in inventories and capital transfers.

Gross Fixed Capital includes expenditures on buildings, construction, machinery etc.

Increase in inventories consists of stores and stocks of food grains.

Capital transfer includes grants for capital formation to the states and union territories

Revenue expenditure and capital expenditure can be classified on the basis of heads of the budget. This classification is also known as functional classification.

31. Pump Priming:

Pump priming is a type of government expenditure which is undertaken with a view to initiate recovery in a depressed economy. The purpose of pump priming is to stimulatate private investment and not to supplant it.

32. Progressive, proportional and regressive expenditure: According to Dalton, just like taxes, public expenditure also possesses the element of proportion, progression and regression.

Public expenditure is progressive if it is incurred on the activities which adds to the real income of the poor in the country.

Public expenditure is proportional if it is more benefitting on different groups of the community in proportion to their income.

Public expenditure is regressive if it is benefitting the people in higher income groups.

3. Expenditure changing policy vs expenditure switching policy.

Expenditure changing policies (also called expenditure adjusting policies) refer to the policies that are aimed at changing (reducing or increasing) the aggregate expenditure in the economy. eg- Monetary policy, fiscal policy etc.

On the other hand, the expenditure switching policy is one that aims at attaining the internal and external balance by switching the domestic expenditure from imported to domestic goods and the other way round. Policy instrument in this case is devaluation

4. Effects of public expenditure on production.

The public expenditure policy is so devised that other things remaining the same, production is increased and encouraged. Public expenditure influences the productive activity in two ways - ~~The effects of public expenditure~~ Directly and indirectly. Public expenditures on industries in public sector, expenditure on railways and irrigation etc are directly productive. On the other hand, expenditure on general administration, post and telegraph is indirectly productive.

The effect of public expenditure on production can be evaluated by enquiring its effects upon the following factors ÷

(i) Effects upon ability to work, save and invest

(ii) Willingness of people to work, save and invest

(iii) Effects on diversion of economic resources as between different uses and localities.

(i) Effects upon ability to work, save & invest: Public expenditure can increase the ability of the people to work, save and invest in many ways.

(a) Promoting the efficiency of persons to work by providing education, medical services etc.

(b) Increasing the purchasing power, standard of living by raising the salaries and wages.

(c) Public expenditure incurred for maintaining law and order, create confidence on the mind of the people and hence it encourages people to make investment in productive activities.

On the other hand if a larger proportion of public expenditure is wasted on social functions, on the production of intoxicants and other articles which are harmful for health and efficiency and that too at subsidised rate may have adverse effects on the ability to work, save and invest.

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(ii) Effects on willingness to work, save and invest: The willingness to work, save and invest depends to a great extent upon the character of the public expenditure and the policy of the govt. Public expenditure which provide security and safety to a person (for eg old age pension) may reduce willingness to work and save. Obviously why should a person work hard and save more when he finds his future secure. Again a person will not work and save, if he considers that his present saving and investment will not earn an income to him in future, i.e if he finds his future insecure.

If the benefits increase with increase in work and the volume of saving, the desire to work and save will increase and vice-versa. The desire to work and save may also increase, if the people are confident that their present savings and investment are secure and will yield good dividends in future

(iii) Effects on diversion on economic resources as between different uses and localities : Every defence problem substract economic resources from other resources from other uses in which they might have made direct contribution to production and economic welfare.

35. Effects of public expenditure on distribution

Public expenditure has its effect not only on production, but it also a most powerful weapon in the hands of the government for bringing about an equitable distribution of wealth. If most of the public expenditure is incurred for the welfare of the rich people, it will result in enlarging the inequalities of income in the country. On the contrary, if most of the public expenditure is incurred for the welfare of poor people, it will result in bringing about a more equitable distribution of income and wealth in the community. 37

Thus a progressive system of expenditure tends to reduce the inequalities of income. Moreover sharper the progression, the stronger is the tendency to reduce the gap between rich and poor, i.e to remove the inequalities of income.

The various forms of progressive expenditure are –

(i) Cash grants – for example, old age pensions, sickness benefit, unemployment benefit etc

(ii) Free and cheap goods and services – for example, public expenditure on the free education and food subsidies.

However progressive expenditure has few limitations as it may discourage the efforts of the people to work and save. Moreover heavy and steeply dose of taxation may hamper the desire of the tax payer to work hard and save more

36. Effects of public expenditure on employment.

Public expenditure programmes may directly help to provide employment to many individuals ~~and~~ by increasing this people's demand for goods and services. Public expenditure may further increase the employment opportunities as the increase in demand will lead to greater production and thus will provide employment to larger numbers. It is, however, true only, if productive instruments on agriculture and industry are not producing what they can produce within their means. If they are already producing at optimum level, the possibilities of increasing production and employment would be less. Thus, public expenditure programmes should be so devised so as to increase production with increase in demand for the product

37. Significance of public expenditure in a modern state

The significance of public expenditure can be judged with the help of the following points:

(i) Public expenditure can provide those services which might not other wise be provided or which could not be provided by insignificant amount by private expenditure

(ii) The significance of public expenditure also arises from the fact that it creates income to the various individuals due to the purchase of goods and services from private firms or individuals for undertaking defence, administrative and developmental activities, which involve the use of resources in the public sector for the use of the country as a whole

(iii) If government uses resources that otherwise would have remained idle, the national income and employment would increase

(iv) Public expenditure, which is in nature of transfer expenditure, involves a transfer of purchasing power from one section to another.

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If the income is transferred to poor people, or to people whose propensity to consume is high, the national income would tend to rise and vice-versa.

39. Reasons for the growth of public expenditure

Public expenditure is the expenditure incurred by the public authorities, i.e central government, state government and local bodies either for the satisfaction of collective needs of the society or for the promotion of economic and social welfare.

Public expenditure has increased in the recent years most and it continuous to be an increasing trend in almost all countries of the world. The important factors behind the continuous growth of public expenditure in the modern welfare state are as follows:-

(i) Growth of population: Along with the growth in numbers, the responsibility of the government relating to public services has been multiplied

(ii) Urbanisation: The spread of urbanisation is another factor for the relative growth of public expenditure in modern times. As newer urban habitations are springing up, per capita cost of water supply, traffic service, control of public protection, health services etc rises.

(iii) Welfare state: Modern states are welfare states. They aim at promoting economical, political and social life of the people. To achieve this, it has to spend huge amount on activities like education, health care etc All these lead to increase in public expenditure.

(iv) Defence expenditure: The national situation all over the world is insecure and uncertain. If one country strengthen its defence, the other countries are also bound to strengthen their own defence: Thus, public expenditure has been mounting due to defence expenditure

(v) Rising trend of prices: With the advance of price levels a governments have been compelled to pay more for the commodities and services that they desire and to increase the salaries, allowance to government employees

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