

**SIZE AND COMPOSITION OF GOVERNMENT EXPENDITURE IN INDIA:
IMPACT ON ECONOMIC GROWTH**

V.SHIVARANJANI

A project report submitted to the

FACULTY OF SCIENCE AND HUMANITIES

In partial fulfillment of the requirement for the award of the degree of

MASTER OF SCIENCE

IN

ECONOMICS



MADRAS SCHOOL OF ECONOMICS

ANNA UNIVERSITY

CHENNAI-600025

MAY 2010

ABSTRACT

The relation between economic growth and government expenditure has evoked considerable conceptual and empirical interest. Evidence has been mixed on the nature of this relationship in several cross-country studies. The focus of the present study is on this question in the Indian context. Issues regarding causality, crowding out and actual growth effects are discussed. The causality analysis, conducted in a vector autoregressive framework for the period 1960-61 to 2007-08, reveals that a break in 1982-83 has to be used. As a result, there is two-way causality between government consumption expenditure and economic growth (growth of GDP_{MP}), but only one-way in the case of public investment (which has a negative influence on growth) in the pre-break period. The break in 1982-83 changes the role of government expenditure on investment from complementary to crowding out with regard to private investment (attributed to reforms from the mid-'80s and a shift in state ideology); the post-break analysis clearly indicates that growth receives a positive thrust from the private sector while the public spending variables report a negative impact.

The growth effects of government size and its components are analysed in a dynamic panel framework (using Arellano-Bond estimation) with fourteen major Indian states from 1980-81 to 2007-08. It is concluded that while overall government size has a negative influence on per capita GSDP growth, increasing public expenditure on education, health and economic infrastructure have significant positive growth effects, with the merit goods category (education and health) showing a higher effect than the other. This indicates that a reallocation towards these would be more beneficial in view of economic growth.

I would like to express my gratitude to Dr.Srivastava and Dr.Bhujanga Rao, who have supervised my project, for their valuable and insightful guidance.

There have also been several spontaneous, engaging and fruitful discussions that have been helpful in shaping my understanding of this inquiry, for which I am deeply indebted to many of my batch mates.