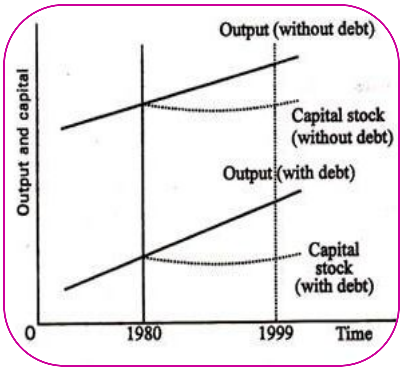
REVIEW OF RESEARCH
ISSN: 2249-894X
IMPACT FACTOR : 5.2331(UIF)
VOLUME - 7 | ISSUE - 4 | JANUARY - 2018
UGC APPROVED JOURNAL NO. 48514

PUBLIC DEBT, PUBLIC EXPENDITURE AND ECONOMIC GROWTH – A THEORETICAL REVIEW

Dr. Deepali Karmali Churi
Asst. Prof at S.S.Dempo College of Commerce and Economics.

ABSTRACT—
Rising Public debt has been a growing concern over many emerging and least developed economies. The percentage of debt to GDP in many countries is close to 100. In order to curtail the rising debt and reduce the burden of debt servicing these economies are trying to reduce their capital expenditure ather than the current expenditure. A review of literature across different time periods and countries would help us to understand the relationship between public debt, public expenditure and economic growth. This paper covers research studies on the basis of empirical analysis from 1950 to 2015 analysing the role of public debt, public expenditure and economic growth across different countries in the world. A re-look and re-designing are a need of the hour for every country whose fiscal deficit is rising and/or are curtailed by curbing capital expenditure.



KEY WORDS: *Public Debt, Sustainable Debt, Economic Growth.*

INTRODUCTION :

An individual could never be debt-free until and unless his state and nation are debt-free. The government of every country are resorting to continuous public borrowing which creates debt burden on the citizens of the country. This burden unfortunately passes on from present to future generations. The ever increasing and expanding size of fiscal deficit has become headache of national and state governments not only in India but worldwide. Elections today are won on the basis of freebies to be distributed rather than on the basis of economic, financial and social reforms needed in the country. Huge public expenditure on numerous welfare schemes results in huge financial burden on the state. Such expenditure is mainly sponsored by resorting to public borrowings or reducing expenditure on capital assets. Both of which are undesirable from the point of view of expected level of economic growth. This paper covers research studies on the basis of empirical analysis from 1950 to 2015 analysing the role of public debt, public expenditure and economic growth across different countries in the world.

PUBLIC DEBT AND ECONOMIC GROWTH

Checherita C. & Rother P. (2010) in their study on the impact of high and growing government debt on economic growth conducted across twelve-euro countries since 1970 revealed a concave relationship between the public debt and economic growth rate. It was found that a higher public debt to GDP ratio is associated with lower long-term growth rates at debt levels above the range of 90-100% of GDP. The channels through which public debt was likely to have an impact on economic growth rate were anticipated to be private saving, public investment, total factor productivity and sovereign long-term nominal and real interest rates. Government budget deficits were found to be linearly and negatively associated with the growth rate of both real and potential output. The researchers rightly point out that if policy makers fear that fiscal consolidation measures would make them unpopular with voters, then they are affecting long term growth rate of the nation and by resorting to higher public debt in fact adding up to fiscal burden on future generations.

Kumar S.M. & Woo J. (2010) attempted to study the impact of increasing public debt on long run economic growth. The analysis is based on panel of advanced and emerging economies from 1970 to 2007. The empirical result suggested an inverse relationship between initial debt and subsequent growth. The econometric model revealed that a 10% increase in initial debt to GDP ratio leads to 0.2% fall in annual real per capita GDP growth in emerging economies and 0.15% fall in advanced economies. The debt above 90% of GDP was found to have significant negative effects on economic growth. This resulted in low labour productivity mainly due to reduced investment and slow growth of capital stock per labour. The authors suggest that public debt needs to decline in medium and long term. Loganathan et al., (2010) revealed that Malaysia's external debt is 'sustainable' with its government's. revenue, balance of payments and foreign exchange reserves. (Nurazira Mohd Daud et al., 2013) found a persistent positive relationship between external debt and economic development. According to the. study, a 1% rise in external debt is related to a 0.78 percent increase in economic growth of Malaysia.

A study by kuman and Woo (2010) concluded that high debt to GDP ratio (over 90%) created a negative impact on growth for thirty advanced and emerging markets economies over the period of 1970 to 2007. Akram N. (2011) studied the relationship between public debt and economic growth of Pakistan for a period of 1972 to 2009. The study revealed that external debt has negative relationship with per capita GDP and investment thus confirming 'Debt Overhang Effect'. Internal debt too was found to have negative impact on per capita GDP and investment. This seemed to have crowded out private investment.

Bal P.D. and Rath N.B. (2014) examined the effect of public debt on economic growth in India between 1980 to 2011. The study used autoregressive distributed lag model to trace the long-run relationship between public debt and economic growth. The error correction model result showed that central government debt, total factor productivity growth and debt services are affecting the economic growth in the short run. The study recommends the use of inter- generational equity in fiscal management over the long term in order to stabilize debt-GDP ratio particularly after global financial crisis. Ahmed & Fareed (2014) investigated the effect of external debt overhauling on the development and growth of Pakistan's economy. The study considered five variables i.e. Growth, external debt servicing, saving, net export, Foreign Direct Investment were taken to focus their association with the GDP or development of Pakistan's economy. Annual panel data was taken for the period of 1980 to 2013 and was manipulated through least square multiple regression models. The external debt has significantly negative impact on GDP so it's concluded that Pakistan should go for the option of debt forgiveness and must invite FDI but not much as their overloading may hurt the economy. Adjusting saving (ADS) highly significant positive relation with GDP reveals that the habit of saving substantially boosts up economic growth. Exports too need to be boosted in order to mitigate the negative impact of external debt.

Baaziz Y. & et al. (2015) investigated the dynamic relationship between accumulated public debt ratio and real GDP growth in the South African economy over the period of 1980-2014. The study used Smooth Transition Regression model which allows regression coefficients to vary depending on the level of public debt. The study concludes that public debt beyond 31.37% of GDP is not desirable as after this critical level the relationship between public debt and growth turns negative. A statistical analysis between government debt and GDP growth of Greece by Spilioti & Vamvoukas (2015) clearly indicates that debt helps in positive growth of GDP up to a certain level beyond which it results in negative growth. In the case of Greece, it was found that a ratio of debt to GDP beyond 110% will result in negative growth of GDP. A.Onaolapo Kayode (2015) examined the impact of external debt management in Economic growth of Nigeria within the period of 2000 -2009. Pearson product-moment correlation test was used to test the hypothesis. The correlation analysis showcased that there exists a negative relationship between the external debt and the Gross Domestic Product (GDP) of the country. It also found that external debt management has significantly affected the country's balance of payment.

Kamundia S.W. (2015) study on effects of public debt on private investments and economic growth in Kenya during 1980 to 2013 concluded that debt played a crucial role in determining the level of private investment and economic growth. The study found a negative relation between debt and private investment but a positive relation between debt and economic growth. The study recommends that government should decide on optimal level of debt which promotes private investment and economic growth. Mohanty A.R. & Mishra R.B. (2016) studied the impact of public debt on economic growth of 14 major states in India for the period of 1980-81 to 2013-14. The study found that economic growth is positively impacted by public debt. The study established bi-directional causality between public debt and economic growth. The analysis revealed that states should adopt expansionary debt policy to help boost economic growth. As per study higher economic growth would provide for more institutional credit for private sector investment. Siddique et al., (2016) investigated the correlations among external debt and economic growth in 40 HIPCs from 1970 to 2007. The results confirmed that debt as a proportion of GDP has a negative influence both in the short and long run.

PUBLIC EXPENDITURE AND ECONOMIC GROWTH

Haque M.E. (2004) evaluated the composition of public expenditure and economic growth in developing countries with the help of cross sectional and panel data. The study tried to analyze the impact of resource switch from one type of public spending to another while the total spending is fixed. The study concluded that switching resources from consumption to investment favorably impacted economic growth and vice versa

Bose N. & Haque M.E. (2007) studied public expenditure and economic growth in 30 developing countries over the period of 1970s and 1980s. Their study concluded that government expenditure on education has a positive impact on economic prosperity of the country. The study stresses on the need on increasing public spending on education at least in some developing countries within their budget constraints. Their analysis also showed a positive relationship between capital expenditure and growth while current expenditure did not have any effect on growth. The study does not imply an arbitrary increase of public expenditure on education as it may result in either increasing taxes or debt. In fact the researchers believe that the increase in expenditure should be either through reduction in current expenditure or should be financed by another sector contributing to GDP.

Dash R.K. & Sharma C. (2008) analysed the impact of government developmental expenditure on India’s economic growth from 1950 to 2007. The study found an investment, trade and developmental expenditure have a positive impact on economic growth. Ogujiuba K. & Abraham T.W. (2012) in their study on Nigeria from 1970 to 2011 revealed that there exist high level of correlation and uni-directional causality between revenue and expenditure. It also implied that a disequilibrium in expenditure can be corrected in the long run through policies that adjust oil and non-oil sector revenues. The lagged regression model justified the need for the use of medium term expenditure framework to monitor expenditure patterns in the short to medium term. The paper concluded that short term shocks from crude oil price pass through oil revenue to affect expenditure. This has led to swings in public expenditure pattern with a sustained increase in revenue expenditure over capital expenditure which in turn adversely affected economic growth. The study recommended effective policies to enhance the performance of the non-oil sector and adoption of expenditure framework that could account for possible decline in crude oil prices as an useful way in building healthy revenue-expenditure relationship in Nigeria.

Gangal V.L.N. & Gupta H. (2013) studied public expenditure and economic growth in India and found that there exists a long run equilibrium between total public expenditure and economic growth. There is unidirectional relationship between total public expenditure to GDP.

Raja A.N.(2013) in her study on expenditure pattern of the central government observed that unprecedented increase in public expenditure especially the wasteful expenditure has reduced the resources available for overall development of the country. In case of India, the governments non-plan expenditure is taking away major chunk of the revenue collection thus adversely affecting the spending ability in the areas of human development and infrastructure growth. The increase in expenditure with lower revenue generation ability gives rise to ever increasing fiscal deficit. The unsustainable level of fiscal deficits is a headache of economies world over. To keep the economy going and with an aim of reducing fiscal deficits the government then had cut down on plan and non-plan expenditure like subsidies. But, government in India actually needs to boost up its expenditure in field of infrastructure, rural development, education, health in order to improve on quality of life and overall development of the society in the long run.

Medhi K. (2014) investigated the causality between government expenditure and economic growth in India during 1974 to 2010. The finding supported unidirectional causality from GDP to public expenditure thereby supporting the applicability of Wagner's law. Lahirushan K.P.K.S. & Gunusekara (2015) examined the impact of government expenditure on economic growth in nine Asian countries during 1997 to 2013. The study concluded the existence of long run relationship and positive impact of government expenditure on GDP in Asian region. They also found bi-directional causality from economic growth to government expenditure and government expenditure to economic growth thus validating Keynesian and Wagnar's view on public expenditure. Makandar N.M. et al (2015) have undertaken study to evaluate the revenue and expenditure pattern of state of Karnataka. The study found that increasing demand for public expenditure are met through increased public borrowings. Though Karnataka is one of the few major states to have highest tax revenue collection, the inelastic nature of taxes necessitates the need for urgent tax reforms to avoid complication in future.

Araf T.C. (2016) studied the trend, growth and changing patterns of public expenditure on education in India and found that the quantum of public expenditure on education has increased since 2001 though it is much lesser than the percentage of public expenditure on education in developed countries like USA, New Zealand, Norway and UK. The study found that the expenditure incurred by the state governments during the period of study has declined while that by central government has increased. Ramu A.M. & Gayithri K.(2016) examined the fiscal deficit composition and economic growth relation in India. The authors analysed the period from 1980-81 to 2012-13 and with the help of Vector Error Correction method concluded that fiscal deficit is adversely affecting India's economic growth but at the same time if fiscal deficit money is spent on capital formation then it would promote economic growth. A study by Amrutha T., et al., in their study based on Johansen co-integration test also found a negative relationship between rise in fiscal deficit and economic growth. Alawneh A. (2017) in his study on the impact of public expenditure and public debt on taxes in Jordan during 2001-2014 revealed a positive relationship between taxes and public expenditure and public debt. Government resorts to internal and external debt in order to undertake public expenditure. The researcher is of the opinion that rather than increasing public debt which increases tax burden, government should resort to other methods like issue of Islamic bonds, participatory instruments etc. to finance its expenditure. Idris M., et al (2017) examined the effects of fiscal deficits on economic growth of Nigerian economy. The study explored the trend of fiscal deficits from 1980 to 2015 and revealed that it had negatively impacted economic growth of Nigeria. The study stressed on the need of higher accountability with respect to public spending in accordance with the principles of equity and efficiency. As per study the public sector should adopt feasible monetary and fiscal policy in order to achieve balanced budget to attain social and economic welfare.

Rao G.M. (2017) studied public finance in India in the context of India's development found that the public expenditure on health and education is inadequate while spending on interest payments, subsidies and transfer have increased. The tax-GDP ratio is found to be lower by 2- 3% as compared to this ratio in 98 other countries. The possible reason for this has been attributed to exemption of agriculture income from taxes, tax abuse my MNCs and poor tax administration. The low tax collection is considered to be reason for debt and fiscal deficits. The paper stresses on creating fiscal council by parliament which gives its recommendation to parliament in line with the finance commission.

DISCUSSION AND CONCLUSION

The research studies analysed above clearly reveal that public debt averaging 90-100% of GDP is bound to have an adverse impact on long-term growth of the country. Rising debt is bound to reduce the levels of private saving, public investment, factor productivity in the country. A rise of 10% in public debt to GDP ratio led to 0.2% and 0.5% fall in annual real per capita GDP growth of emerging and advanced countries respectively. Surprisingly, a study on Malaysia found a positive relationship between external debt and economic growth of the country. Studies recommend policies encouraging FDI or increasing exports over the policy of consistent borrowing by government. Inter-state study in India found a positive impact of public debt on economic growth.

Public expenditure and economic growth shows that expenditure leading to productive investment has a favourable impact on economic growth. Public expenditure on education has helped in increasing economic prosperity of the country in 30 developing countries. The research focusses on need to increase capital expenditure and curtail current expenditure. Studies have also cautioned against increase in taxes or debt to finance expenditure on education. Increase in unproductive and wasteful expenditure was found to have negative impact in areas of human development and infrastructure growth in India. Unfortunately, countries like India experience rise in fiscal deficit due to increase in public expenditure over public revenue. A bi-directional relationship is explored between GDP and public expenditure. It means the two positively impact each other. Rising fiscal deficit is reducing public expenditure on health and education while expenses on interest payment, subsidies are rising.

Research studies ranging from 1950 till 2015 stress and clearly highlight a relationship between public debt, public expenditure and economic growth across advanced, emerging and least developed countries. This relationship holds true for specific state within a country. There exist a negative relationship between public debt and economic growth beyond a threshold limit of GDP.

Based on well researched empirical studies, it can be concluded that nations world-wide need to relook in to pattern of public expenditure and devise a mechanism to increase public expenditure in areas of core importance such as education, health and infrastructure. But it ought to be done by keeping public debt within the threshold limit as prescribed by IMF, so as to avoid any possibilities of economic or financial crisis in future.

REFERENCES

- Baaziz Y., 'Does Public Debt Matter For Economic Growth?: Evidence From South Africa, Journal of Applied Business Research, November 2015, www.researchgate.net.
- Akram N., 'Public Debt, Corruption and Sustainable Economic Growth of Pakistan' , December 2011, www.mdpi.com.
- Impact of Public Debt on the Economic Growth of Pakistan, www.researchgate.net.
- Kobayashi K, 'Public Debt Overhang and Economic Growth' Policy Research Institute, Ministry of Finance, Japan, Public Policy Review, vol.11, No.2, March 2015. www.mof.go.jp.
- Checherita C. & Rother P., 'The impact of high and growing government debt on economic growth: An empirical investigation for the Euro Area' working Paper series, No. 1237/ August 2010. www.ecb.europa.eu.

- Kamundia S. W., 'The effects of public debt on private investments and economic growth in Kenya (1980-2013)' July 2015, ir-library.ku.ac.ke.
- Alawneh A., 'The Impact of Public Expenditure and Public Debt on Taxes: A case study of Jordan' Accounting and Finance Research, vol. 6, No.3, 2017.
- Kumar M.S. & Woo J., 'Public Debt and Growth' IMF working Paper, WP/10/174, 2010
- Pasha S.M.,et.al., 'An overview of India's Debt: An analytical study' International Journal of Applied Research, 2015, ISSN 2394-5869
- Bal Prasad D., Rath N.B., 'Public debt and economic growth in India: A Reassessment – semanticscholar.org, 2014
- Welham B. et.al., 'Linkages between public sector revenues and expenditures in developing countries', Shaping policy for development, odi.org
- Deller S., & Stallmann, 'Tax and Expenditure Limitations and Economic Growth' Marquette Law Review, www.scholarship.law.marquette.edu
- Mitchell D., 'The Impact of Government Spending on Economic Growth', Report Budget and Spending, heritage.org, March 2005.
- Vora A., 'Analysis of public income and expenditure by Indian government', International Journal of Applied Research, ISSN 2394-5869, 2016.
- Makandar N.M. et. al., 'Revenue-Expenditure Management: A Study oKarnataka State,elkjournals.com
- Ogujiuba K. 7 Abraham T.W., 'Testing the Relationship between Government Revenue and Expenditure: Evidence from Nigeria, International Journal of Economics and Finance, vol.4, No.11, 2012.
- Araf C.T., 'Trends, Growth and Changing Patterns of Public Expenditure on Education in India', journal of Global Economics, vol. 4, December 2016.
- Raja A.N., 'Expenditure Pattern of the Central Government', ccilindia.com.
- State finances a study of budgets of 2016-17 - Reserve Bank of India, May 2017
- Haque M.E, 'Public Expenditure and Economic Growth: A Disaggregated Analysis for developing countries', researchgate.net
- Haque M.E., 'The composition of public expenditure and economic growth in developing countries', Researchgate.net.
- Seshaiah S.V. et.al., 'General Government Expenditure and Economic Growth in India: 1980-81 to 2015-16' www. Scirp.org
- Gangal V.L.N. & Gupta H., 'Public Expenditure and Economic Growth: A Case Study of India', Global Journal of Management and Business studies, Vol. 3, 2013, ISSN 2248-9878
- Sharma C., & Dash R.K., 'Government Expenditure and Economic Growth: Evidence from India', ideas.repec.org
- Lahirushan K.P.K.S. & Gunasekara W.G.V., 'The Impact of Government Expenditure on Economic Growth: A Study of Asian Countries' International Journal of Humanities and Social Sciences, Vol:9 No.9, 2015
- Medhi K., 'An Empirical Investigation of the Causality between Government Expenditure and Economic Growth in India During 1974-2010', IOSR Journal of Humanities and Social science, Vol. 19, Issue 7, July 2014
- Idris M., et. Al., 'The Effects of Fiscal Deficits in Developing Countries: Implications on the Economic Growth of Nigeria', International Journal of social science and Economic Research, vol. 2, issue 9, September 2017, ISSN 2455 – 8834
- Fatima G., et.al., 'Consequential Effects of budget deficit on economic growth of Pakistan', International Journal of Business and Social Science, vol.3, no.7, April 2012
- The Impact of Fiscal Deficit on Economic Growth in India, www.shodhganga.inflibnet.ac.in
- Hussain M.E. & Haque M., 'Fiscal Deficit and Its Impact on Economic Growth: Evidence from Bangladesh' Economies 2017, www.businessinsider.com

- Ramu M.R. & Gayithri K., 'Fiscal deficit composition and economic growth relation in India: A time series econometric analysis', ISEC, Bangalore, January 2017, MPRA Paper No. 76304,
- Amrutha T., et.al, 'Impact of fiscal deficit on economic growth in India - A Cointegration Analysis, International Research Journal of Agricultural Economics and Statistics, Volume 8, Issue 1, March 2017, e ISSN 2231-6434.
- Mohanty R.K., 'Fiscal Deficit – Economic Growth Nexus in India: A Cointegration Analysis, www.pdfs.semanticscholar.org
- Renjith P.S. & Shanmugam K.R., 'Sustainable Debt Policies of Indian State Governments' WORKING PAPER 171/2018, MSE, India
- Revenue And Expenditure of Major States in India, www.Shodhganga.inflibnet.ac.in
- Das Gupta A., 'Non-Tax Revenues in Indian States: Principles and Case Studies', www.researchgate.net
- India – Basic Socio-economic Indicators, A joint-study of UCLG and OECD, October 2016, www.oecd.org
- Rao Govinda M., 'Public Finance in India in the Context of India's Development', National Institute of Public Finance and Policy, Working Paper No. 219, December 2017, New Delhi.
- Nair S.R. & Sensarma R., 'State Finances of Kerala - Performance, Challenges and the way ahead'- IIM Kozhikode, October 4, 2017
- A.Onaolapo Kayode, S. O. (2015). Impact of External Debt Management in Economic Growth: A Lesson from Nigeria. *Research Journal of Finance and Accounting*, *6*(5), 74–80.
- Ahmed, N., & Fareed, Z. (2014). Impact of External Debt on Economic Growth: a Case Study of Pakistan. *European Researcher*, *Vol. 89*(89), 2133–2140. https://doi.org/10.13187/er.2014.89.2133
- Loganathan, N., Sukemi, M. N., & Sanusi, N. A. (2010). External Debt and Macroeconomics Performance In Malaysia: Sustainable Or Not? *Global Economy and Finance Journal*, *3*(2), 122–132.
- Nurazira Mohd Daud, S., Halim Ahmad, A., & Azman-Saini, W. (2013). Ekonomska Istraživanja-Economic Research Does External Debt Contribute To Malaysia Economic Growth? 52 Does External Debt Contribute To Malaysia Economic Growth? *Economic Research*, *26*(2), 51–68.
- Siddique, A., Selvanathan, E. A., & Selvanathan, S. (2016). The impact of external debt on growth: Evidence from highly indebted poor countries. *Journal of Policy Modeling*, *38*(5), 874–894. https://doi.org/10.1016/j.jpolmod.2016.03.011
- Spilioti, S., & Vamvoukas, G. (2015). The impact of government debt on economic growth: An empirical investigation of the Greek market. *Journal of Economic Asymmetries*, *12*(1), 34–40. https://doi.org/10.1016/j.jeca.2014.10.001
- Kim et.al (2017), Public Debt, Corruption and Sustainable Economic Growth , Sustainability*,* 9*(3), 433*