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इ-मेल email: helpdoc@rbi.org.in

संचार विभाग, केंद्रीय कार्यालय, एस.बी.एस.मार्ग, मुंबई-400001

DEPARTMENT OF COMMUNICATION, Central Office, S.B.S.Marg, Mumbai-400001

फोन/Phone: 91 22 2266 0502 फैक्स/Fax: 91 22 22660358

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RBI Working Paper Series - 7
Size of Government Expenditure Multipliers in India:
A Structural VAR Analysis

The Reserve Bank today placed on its website a Working Paper titled “[Size of Government Expenditure Multipliers in India: A Structural VAR Analysis](#)”. The paper has been authored by Dr. Rajeev Jain and Shri Prabhat Kumar.

In the recent years, active fiscal policy has been used across countries to mitigate the negative macroeconomic shocks generated by the global financial crisis in credit markets and banking systems. This, in turn, led to a considerable discussion among policy makers and researchers regarding the potential effectiveness of fiscal policy as a stabilisation tool. In case of India as well, the Central government undertook three stimulus packages during December 2008 - March 2009. Thus, it is important to estimate the size of expenditure multipliers as it not only reflects upon the quality and effectiveness of fiscal policy but also assumes importance when there is a need for undertaking a credible fiscal consolidation.

Against this background, a study “Size of Government Expenditure Multipliers in India: A Structural VAR Analysis” was undertaken which estimated the size of expenditure multiplier at the level of Central and the State governments, using annual data for the period from 1980-81 to 2011-12. The structural vector autoregression framework was used to gauge the effects of various categories of government expenditure on India’s GDP. The major findings of the paper are:

- It is estimated that combined expenditure by Centre and States leads to a multiplier effect of 0.59 on GDP. Since the revenue expenditure accounts for a major share in aggregate expenditure at both levels of government, the impact multiplier for overall expenditure is estimated to be less than one and it is found that the positive impact dissipates immediately after the first year of shock.
- The size of multiplier for all categories of expenditure by State governments is estimated to be larger than that of the Central government. As was *a priori* expected, capital outlay is found to be more growth inducing and have prolonged impact than revenue expenditure in case of both, Centre and States.
- Empirical findings suggest the need for change in composition of expenditure in favour of capital outlay and greater decentralisation of expenditure.

The Reserve Bank of India introduced the RBI Working Papers series in March 2011. These papers present research in progress of the staff members of the Reserve Bank and are disseminated to elicit comments and further debate. The views expressed in these papers are those of authors and not those of the Reserve Bank of India. Comments and observations may kindly be forwarded to authors. Citation and use of such papers should take into account its provisional character.

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Alpana Killawala
Principal Chief General Manager