

Constructing the Rahn Curve of India

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Abstract

This paper explores the influence of fiscal deficit on economic growth rate in an attempt to test the proposition of Rahn (1996) that there is an optimal size of public spending below which it tends to daunt the process of economic growth.

Keywords: Rahn Curve, Optimal government size

Introduction

The debate whether smaller governments or larger governments are conducive for economic prosperity is a matter of political overtones with the leftist position of interventionist public lead economy to market fundamentalist position of fiscal austerity. Richard W. Rahn, an American economist in 19996 illustrated a notion of optimal government size which maximised economic growth. The inverted U shape of the curve is consistent with the classical liberal position of lower government spending and duties.

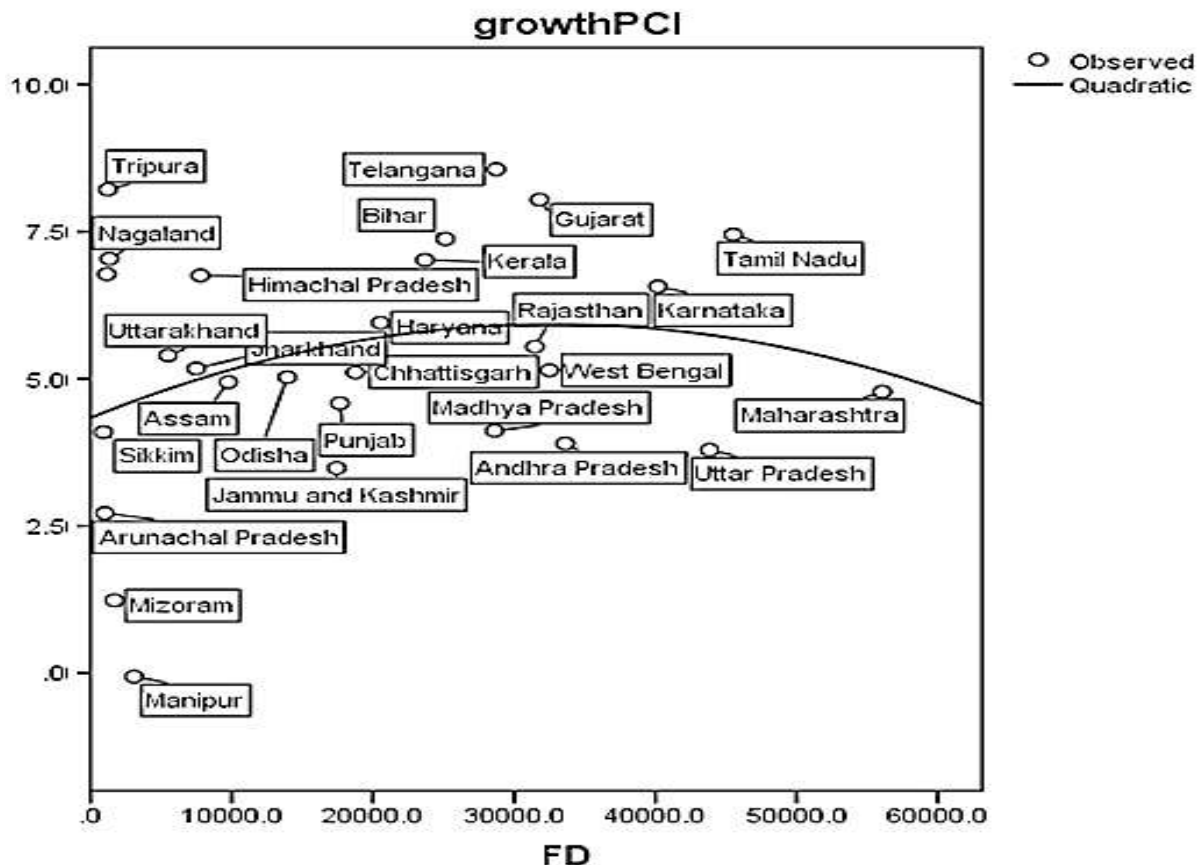
Data

Fiscal deficit was used as a proxy for the size of the government. Data on fiscal deficit across Indian states was collected from RBI Handbook of Statistics on Indian States(2021).

Results and Discussion

Fiscal deficit of states of India was plotted across economic growth in a plot. The data fit well for a quadratic regression model consistent with the proposition of Rahn giving an inverse U shaped curve.

Figure 1: Rahn Curve of India



Growth expanded with fiscal deficit initial up to a maximum beyond which the same tend to fall. It was found that a Fiscal Deficit of 5.7 is percapita NSDP growth maximising

Summing Up

According to the Rahn Curve, there is an optimal public spending that maximises economic development. Higher government spending initially aids in improving economic performance. However, if government expenditure reaches a certain level, taxes and involvement by the government erode economic growth rates. It was found that a Fiscal Deficit of 5.7 is percapita NSDP growth maximizing among states in India.

References

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