

FISCAL POLICY IN NORTH-EAST INDIA



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B. MISHRA

This book explores the existing pattern of allocation of financial resources between the union of India and its constituent units that have generated imbalances between the revenue capacities and the needs of the States much to the disadvantage of the backward states of India. In this particular context, the book makes a successful attempt at enquiring into the nature, causes and dimensions of such maladjustments and imbalances, taking North-Eastern region as a whole. The book is considered to be unique in it as no similar work is available on this particular aspect of the problem for North-East India.

Written in a simple language, Fiscal Policies in North-East India is divided in to Six Chapters. The general outline of the book includes an in depth analysis of the problems and prospects of financial resources of the North-Eastern states, an analysis of public expenditure growth, where an attempt is made to assess the overall utilization pattern of the states' financial resources, an analysis of efficiency of North-Eastern states' tax system and finally suggests some policy measures to over come inherent fiscal adversaries that these states experience. The present book will prove to be of immense value to the Post-graduate students, Research Scholars, fiscal analysts, planners, policy makers, academicians and the taxation theorists.

Rs. 450

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PREFACE

Over a period of time, North-Eastern states have developed a dependency syndrome as it is evident from an explosive cycle of public expenditure growth in most of the states of the region, coupled with an increasing demand for grants-in-aids and other Central assistance to bridge the gap of large budgetary deficits. The inadequacy in generating their own sources of revenue to meet the challenge of a volatile fiscal situation may be attributed to a number of factors. They are : (i) the low level of economic activities coupled with a low level of economic base, which may be considered as a product of low level of infrastructural development (ii) emergence of a parallel economy not only due to flourishing trade of imported goods and commodities from the neighboring countries but also due to the various fringe tax benefits of direct taxation particularly of Income tax and lastly (iii) due to the social unrest and political instability that these economies experience from time to time. As a whole, the repercussion effects of all these forces at work has resulted in various leakages not only in tax generating capacity but also in narrowing down the tax base of various taxes in the region. If we are to assign a cause- effect relationship to this type of vexed problem then we can argue that the failures on the part of the state governments in this region to mobilize adequate financial resources in order to carry out their various developmental plan programs, has been mainly responsible

for their low level of economic activities, low level of economic base and their final culmination in the form of social unrest. This poor state of affairs in the fiscal front of the North-Eastern states may be termed as *tribal fiscal dilemma* that haunts all the north-eastern states. In a welfare characterized state, fulfillment of social desire to have a better quality of life is dependent not only on the capacity of the government to mobilize adequate resources but also on the degree of momentum of the economic activities that a state in question attains. In the absence of a desired level of economic tolerance to the expanded economic activities, mobilizations of adequate resources for carrying out their developmental works are left to the mercy of the capacity of the government to mobilize adequate resources.

The book is an attempt to accomplish the above anomalies by analyzing fiscal position of Northeastern states from the angles of resource mobilization (level of revenue) and its utilization (level of public expenditure). By applying four indicators, viz. compound growth rate, marginal tax rates, and elasticity and buoyancy coefficients to the North-Eastern states tax structure, the present book tries to assess the fiscal performances of these states in terms of their problems and prospects to achieve a reasonable degree fiscal capacity to carry out their developmental works.

I hope that the present book will prove to be of immense value to the post-graduate students, Research scholars, fiscal analysts and the taxation theorists. I believe that the book will seek to offer a guideline for further intellectual exercises on the same line.

I would like to place on record my deep sense of indebtedness to Prof. T. Mathew, from whom I learnt and developed an interest for Public Finance.

My obligations to all my colleagues in the Department of Economics, NEHU, Shillong, who have been the guiding spirit

and the beacon light in all my endeavors, shall remain ever unpaid.

I owe a special debt of gratitude to Prof. E.D.Thomas, Prof. S.K.Mishra and Prof. P.Nayak and Dr. P.S. Suresh who have helped and encouraged me in various ways while preparing the manuscript.

I find no words to give my innermost feelings for my wife (Sujata) and my son (Echo) for their silent sacrifices without which, I could not have dreamt of completing this work.

I dedicate this humble work to all of teachers who taught me Economics.

B. Mishra

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CHAPTER: I

INTRODUCTION

1.1 Background of the Study

In recent years the government activities vis-à-vis public expenditure have grown both relatively and absolutely in all the states of the Indian federation. With the expansion of the Governmental activities, the magnitude of plan expenditures of the state Governments have increased tremendously which in turn has given rise to the need for a rapid increase in revenue. This has resulted in a situation where, most of the state Governments have increasingly, began to restructure their tax system to generate higher revenue or to improve the taxable capacity or tax efforts with a motive to counterbalance the ever increasing public expenditures. Further it is generally felt that to a large extent, the financial problems of the state arise from its lack of tax efforts, i.e. its failure to mobilize adequate resources to meet its increasing demand for various developmental public expenditure programmes. In working out a developmental plan which implicitly takes into account both the tax and public expenditure ratios; a major question that always arises is how much tax and non-tax revenues can a country/ state reasonably expect to raise and what sources should be tapped in order to meet the ever increasing demand for public expenditures so as to bridge up the widening fiscal gap?

In a federal set up, the financing of the state development plans depends to a great extent on the mobilization of resources by the state Governments mainly through the imposition of varieties of taxation. Efforts made in this direction from time to time have not uniformly succeeded. Being federal in structure, the state Governments has limited statutory powers to levy taxes to finance its various infrastructural facilities and welfare programmes. This may be ascribed to the fact that while bulk of the federal revenue has been derived from more elastic sources, implying that the revenue from these taxes increases proportionately, if not faster than income, the sources of the state Government are relatively less elastic, as reported by Rao (1992)¹.

Further, in the recent past, the Federal Government has signaled a general resource crunch. This has necessitated reduction on outlays on the centrally sponsored development schemes to the states on the one hand and a major cut in subsidies and grants on the other. Thus, the outlays of the states have been substantially affected, thereby forcing the State Governments to postpone some of their developmental programmes. This has no doubt slowed down the pace of economic development of the states. As a result the existing pattern of resource allocation of the financial resources between the union of India and its constituent units has generated imbalances between the revenue capacities and the needs of the states much to the disadvantage of the backward states and particularly the states in north-eastern India. In this context, the present study is a humble attempt to enquire into the nature, causes and dimensions of such maladjustments and imbalances in different states in North-Eastern Region.

With the expansion of the Governmental activities, the magnitude of plan expenditures of the state Governments have increased tremendously which in turn has given rise to the need for a rapid increase in revenue. It is expected that,

the sources of revenue should grow automatically at the required rate. But the experiences of most of the state Governments in India negate the above proposition. As a result of which, this has created a widening gap between the state's expenditure responsibilities on the one hand and available resources on the other, thereby giving rise to the problem of attaining an appropriate degree of financial self-reliance on the part of the most of the state Governments in India. However it is also felt that to a large extent, the financial problems of the states arise owing to lack of tax efforts on their own part to raise additional resources. On this account, the need for an in-depth analysis of the fiscal anomalies at the state level has been felt for quite some time.

In federal India, the emergence of a situation is evident in which, some states are excessively dependent on federal transfers, while others resort extensively to overdrafts, which can be attributed either to the failure on the part of the state Governments in tapping all the productive sources of revenue or to the fact that a 'critical limit' as regards to tax effort as well as taxable capacity has already reached in case of most the states. This excessive dependence of the states on the centre is not all conducive to the development of sound federal fiscal conventions. This scenario makes a strong case for analyzing the states fiscal condition.

Thus the existing pattern of resource allocation of the financial resources between the union of India and its constituent units has generated imbalances between the revenue capacities and the needs of the States much to the disadvantage of the backward states of India. In this particular context, we have made a successful attempt at enquiring into the nature, causes and dimensions of such maladjustments and imbalances, taking North-Eastern Regions as typically backward states.

To counter balance this, it is believed, that the State Governments may have to resort to either of the following two alternatives to seek higher revenue.

- (i) The first recourse before the State Governments may be to re-structure their tax system in such a way so as to yield more revenue. But, the manner in which increasing revenue may be realized through a properly structured tax system at any given time is largely conditioned not only by the various socio-economic and political factors, but also by the efficiency of the State's administrative apparatus, which sets important limits to the ambit, pattern and structure of taxation (Lakdawala, D. T. and Nambiar, K. V., 1972)². We must make absolutely clear at the outset that, there has been no attempt on our part to go into this particular aspect of the problem.
- (ii) The second alternative that we can spell out runs in terms of improving the revenue elasticity and buoyancy of the tax structure, so that the tax system will show an automatic response to the growth of the Net State's Domestic Product. The high degree of tax responsiveness to our view may set a limit to an 'optimal level' of taxation on the one hand and to an 'optimal level' of tax effort on the other. To what extent, the State's Government can achieve or have already achieved this objective is an open question. Therefore, the present study is a modest effort in this direction to find out a suitable answer to the above question, by taking into account this second aspect of the problem of State's finances.

1.2 Problem Formulation

Over a period of time, North-Eastern states have developed a dependency syndrome as it is evident from an explosive cycle of public expenditure growth in most of the states of the region, coupled with an increasing demand for grants-in-aids and other Central assistance to bridge the gap of large budgetary deficits. The inadequacy in generating their own sources of revenue to meet the challenge of a volatile

fiscal situation may be attributed to a number of factors. They are : (i) the low level of economic activities coupled with a low level of economic base, which may be considered as a product of low level of infrastructural development (ii) emergence of a parallel economy not only due to flourishing trade of imported goods and commodities from the neighboring countries but also due to the various fringe tax benefits of direct taxation particularly of Income tax and lastly (iii) due to the social unrest and political instability that these economies experience from time to time. As a whole, the repercussion effects of all these forces at work has resulted in various leakages not only in tax generating capacity but also in narrowing down the tax base of various taxes in the region. If we are to assign a cause- effect relationship to this type of vexed problem then we can argue that the failures on the part of the state governments in this region to mobilize adequate financial resources in order to carry out their various developmental plan programs, has been mainly responsible for their low level of economic activities, low level of economic base and their final culmination in the form of social unrest.

It is evident from the above discussion that most of the State Governments in Indian Federation face severe budgetary pressures with rising demand for expenditures. Further, it is generally argued that the financial problems of the States arise from their lack of tax efforts, i.e., their failure to mobilize adequate resources from sources within their own jurisdiction. As a result of which, the financial dependence of the States on the Union Government has been on the increase in recent years. However, it is felt that, the resources available to the States under present dispensation are not adequate for meeting their requirements. We intend to accomplish this by analyzing fiscal position of Northeastern states from the angles of resource mobilisation (level of revenue) and its utilization (level of public expenditure)

North-Eastern region is comparatively a background

region, where agriculture is the predominant sector, providing means of livelihood to more than 85 percent of the population. Though significant development has taken place in some sphere since Independence, access to opportunities for a 'reasonably minimum' standard of living in this region is one of the lowest in the country. The fiscal health of the states in this region is by no means encouraging at all, where the States' Own Tax Revenue contributes hardly 17 percent of the total tax receipts of the states. Further, the tax revenue constitutes near about 13 percent of the aggregate revenue of the states. In these states, where the states' own tax revenue contributes no more than 10 percent of the state's income and the aggregate Government expenditures constitutes about 115 percent of the state's income. If, we are allowed to use a terminology for this poor state of fiscal affairs, then we will call it a *tribal fiscal dilemma* that haunts all the north-eastern states. In a welfare characterized state, fulfillment of social desire to have a better quality of life is dependent not only on the capacity of the government to mobilize adequate resources but also on the degree of momentum of the economic activities that a state in question attains. In the absence of a desired level of economic tolerance to the expanded economic activities, mobilizations of adequate resources for carrying out their developmental works are left to the mercy of taxable capacity of the states. It is against this back ground, we intend to undertake an inter-temporal study on the efficiency of the tax system in various states in the North Eastern Region. It is, therefore, worthwhile to study the various aspects of the effects of state taxation and expenditures and the dimensions of its movements over the years.

Thus, the overall picture that emerges is that, the tax generating capacity of the North-Eastern states does not cope up with its increased public expenditure programmes, for achieving a desirable rate of economic progress. This exhibits

clearly the low level of tax effort measures on the part of the state governments in the overall scheme of resource mobilization for developmental purposes. As a result of which, economic backwardness has been the resultant outcome.

Based on the above logic, it can be argued that if North-Eastern states' tax policy is to serve the ends of economic development, it should aim to attain at least two objectives³. One of the most powerful instruments of resource mobilization is considered to be the tax system. Therefore, the tax system should aim at (i) in siphoning off into the state exchequer as much revenues as can be gathered in the tax net (without discouraging the incentives for private savings and investment) and (ii) in helping to release resources for private (or public) investment by reducing current consumption.

In the back drop of the above facts, the study argues that the remedial approach to tackle the ever increasing fiscal gap lies in attaining an appropriate degree of financial self-reliance. No doubt, any attempt by the state governments to achieve financial self reliance will depend upon a sound fiscal capacity. Further, a sound fiscal capacity of a state remains the logical off-shoot of a highly productive, responsive and efficient tax structure. To what extent North-Eastern states' tax system adheres to the notion of sound fiscal capacity remains an open question. Therefore, the two major research questions that we have touched upon in this context are: (i) to measure the extent to which the revenue capacity of these states' tax system has been realized and (ii) to assess the overall success of government measures to increase revenue potentialities of the tax system and the North-Eastern states' overall capacities to raise the tax-income ratio overtime.

There are six available indicators to assess North-Eastern states' performance with respect to the above two objectives. These indicators are: buoyancy and elasticity, compound growth rate, marginal tax rate, tax ratio and tax effort of the tax system in vogue. Of these six indicators, the tax ratio

and the tax effort measures generally do not indicate the efficacy of the revenue structure of the states' government as they do not take into account the taxable capacity. Thus, we are left with the choice of applying the compound growth rate and marginal tax rates and elasticity and buoyancy coefficients to the tax structure so as to assess directly the productivity, efficiency and responsiveness of states' tax structure. So, it is clear that, if the state's tax structure satisfies four conditions, namely, that: (i) the marginal tax rate increases with every increase in per capita income; (ii) average tax rate responds positively to the changes in tax base, (iii) the buoyancy of taxes is substantially higher than unity; and (iv) the elasticity is equal to or marginally greater than unity, then it can be said that the states tax system/resource mobilization programmes have performed satisfactorily, given its relative taxable capacity. The effectiveness of North-Eastern states' tax system is assessed in the context of these four norms.

On the state level, tax revenue may change through automatic response of the tax yield to changes in State Income and, or, through the imposition of new taxes, revision of the rates, stricter tax compliance and other administrative measures backed by legal action. Changes in the tax yield resulting from modifying such tax parameters (i.e., rates, bases etc.) are called discretionary changes, which may incidentally involve some legislative action. Changes in the tax yield flowing from the combined effects of automatic responses as well as discretionary changes constitute the "buoyancy" of a tax. On the other hand, with tax parameters held constant (i.e., discretionary changes being removed) automatic changes in the tax yield resulting from variations in the state income measures the "elasticity" of a tax or a tax system.

The need for undertaking such an analysis for the state taxation in North-Eastern States arises due to the following reasons.

Since the buoyancy coefficient compares the actual growth of tax revenue with the growth in State Income, it indicates the following resultant outcome. First, it helps in assessing the overall success of Government's measures to increase tax revenue. Secondly, to the extent that the buoyancy is low, it would suggest a need for devising a tax structure which would overcome the deficiencies. Thirdly, on the basis of such study, the state Government can estimate the probable tax revenue with unchanged base and the rate of tax, consequent on more increase in the State Income.

The elasticity coefficient on the other hand, indicates the inherent responsiveness of a tax system to changes in the State Income and also it reflects, how far the revenue potential of a given tax system has been realized.

It is against this theoretical problem, a humble attempt is being made in this work, to throw some light on the problems of estimating elasticity and buoyancy of the state taxes in the North-Eastern Region, in order to determine the degree of responsiveness of the state taxes to the state's Domestic Product. This is to our view will exhibit the relative degree of efficiency of state tax measures and will indicate the extent of additional tax efforts needed to increase the revenue of the Government.

1.3 Scope and Objectives of the Study

The study covered a period of 38 years from 1963 to 2001. This is a period during which the North-Eastern States' economy has passed through phases of both upswing and downswing owing to wide fluctuations in their agricultural sector as well as political instability and social tensions. Further, this entire period witnessed political instability and social tensions leading to substantial changes both in its expenditure and taxation policies in the entire North-eastern States. It may be mentioned here that the relevant data on discretionary changes in tax revenue are unavailable for the states of Mizoram, Tripura, Manipur and Arunachal Pradesh.

Therefore, for the purpose of inter state comparison of the elasticity and buoyancy coefficients within the North-Eastern region; we made an attempt to estimate the discretionary response of the various taxes of these states by taking into account the tax base of various taxes and the changes in tax rates over the years. To that extent, the tax responsiveness analysis of these states may slightly over state or under state the results. It may be mentioned that wherever possible, for the inter-state comparison within the North-Eastern region, we thought it imperative to take two representative states, namely Meghalaya and Nagaland as the area of our study. The reason for choosing these two states is one fold. It is observed that in recent years, the state of Meghalaya has preferred to maintain a surplus budget while that of the state of Nagaland continues to have a deficit budget over the years. Thus, we believe that inter state comparison between these two representative states may throw some light on the scope of additional resource mobilisation and the resultant patterns of its utilization in other different states of North-Eastern region. Keeping these general problems in view, an attempt has been made in this work to study in detail the following aspects of state taxes.

- (i) An assessment of the overall success of the Government measures to increase Government revenue.
- (ii) An analysis of the growth of tax revenue consequent on the growth of Gross State Domestic Product and, to determine the extent to which the North-eastern region's tax system is responsive to changes in State Income overtime.
- (iii) To measure the extent to which the revenue potential of the North-eastern region's tax system has been realized.

However, the main focus of our study as mentioned earlier has been on the analysis of elasticity and buoyancy

of the tax system as a whole and of each individual tax to changes in tax base and in the State Income.

1.4. Sources and Limitation of Data

The study has been based primarily on the secondary sources of data. The main sources of data are; Annual budgets/ Finance account of the various state governments including their memorandum submitted to the various finance commissions for the period covered by our study. Whenever possible, the budgetary data relating to India published in CMIE and RBI annual reports on Currency and Finance were used and consulted. We have also used wherever possible the budgetary data relating to India as published from time to time in the Reserve Bank Bulletin and the RBI annual reports on Currency and Finance.

1.5 Methodology

The data has been analyzed with the help of suitable statistical techniques and the results obtained have been subjected to relevant economic logic.

Simple regression equations are fitted to the data (by the method of least square) to estimate the trends and fluctuations in revenues and expenditures of the two representative states of North-Eastern region for the period under study. To study the shifts in the relative shares of various taxes and non-tax sources in states' own revenue, we have made use of the statistical technique of time series analysis. Specific techniques and measures are described fully as and when used.

1.6. Work Plan

The topical organization of the work is as follows. For the purpose of expositional convenience and systematic analysis, the work has been divided into six parts namely (1) Introduction, (2) Review of Literature and Methodology (3) problems and prospects of resource mobilisation of the states (4) Expenditure policies of the states (5) Elasticity and

buoyancy of state tax system as a whole and that of individual taxes, and (6) Policy Implications.

Chapter -1 is intended to be Introductory in nature. In this section, we have addressed ourselves to the intricate problems and issues involved in the state finance. Besides, this chapter also incorporates a description of the methodology followed in this study and the sources and limitations of data.

Chapter-II is devoted to the statistical methods used to evaluate the fiscal position of the North-Eastern states. An attempt has been made to give a comprehensive account of the major conceptual and empirical issues relating to the analysis of tax efforts and tax responsiveness. An attempt is made to develop an alternative model of elasticity and buoyancy for measuring the responsiveness of North-Eastern Region's tax system by taking into account the difficulties associated with the estimation of elasticity and buoyancy of the tax system.

Chapter - III is an attempt to examine the problems and prospects of financial resources of the states. The purpose of this is to present an over view of all the states' finance for determining the degree of financial dependency of the state on the Union government. An attempt has also been made in this chapter to determine the extent to which North-Eastern region's economy is financially self-reliant in mobilizing adequate resources from sources within its own jurisdiction. An attempt is made in this chapter to apply the first group of indicators as mentioned earlier, i.e. Compound growth rate, Marginal and Average tax rate to assess the level of fiscal tolerance of the region.

Chapter - IV is concerned with the critical analysis of public expenditure growth, where we made an attempt to assess the overall utilization pattern of the states' financial resources for the entire 38 years covered by our study. We

have also carried out a brief analysis of the growth of public expenditure consequent upon the growth of Gross State Domestic Product in order to ascertain its degree of variation with respect to states' income. It may be mentioned here that for the purpose of inter state comparison within the North-Eastern region, we thought it imperative to take two representative states, namely Meghalaya and Nagaland to ascertain the intricacies of of public expenditure growth in the North-Eastern States. The reason for choosing these two states is one fold. It is observed that in recent years, the state of Meghalaya has preferred to maintain a surplus budget while that of the state of Nagaland continues to have a deficit budget over the years. Thus, we believe that inter state comparison between these two representative states may throw some light on the resultant patterns of its utilization in other different states of North-Eastern region.

An estimation of elasticity and buoyancy of the state tax system as a whole is carried out in Chapter-V., and, in Chapter -VI, we present the policy implications.

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CHAPTER-VI

SUMMARY AND CONCLUSIONS

The present chapter is an attempt to present a comprehensive account of the major findings of the study. The important findings of the study are as follows.

An analysis of the percentage share of state's total tax revenue and shared taxes in the net state domestic product exhibited some disturbing results. The percentage of State's own tax revenue to net state domestic product, increased slowly over the years in case of both the states. If, we judge the performances of the State's own tax revenue on the basis of its contribution to State income, then the performances of the State's own tax revenue presents a poor picture altogether. From this point of view, the State's own tax revenue has been increasing at a very slow rate during the period of our study. If we visualize tax-income ratio as the simplest measure of tax burden or sacrifice then the analysis revealed that the ratio has marginally increased in both the states of Nagaland and Meghalaya implying thereby the existence of a static tax structure over the years. This only proves that the States of North-Eastern region fare rather poorly on this count.

The analysis of the ratio of the State's own tax revenue to the total tax revenues accruing to the State was an attempt to ascertain the degree of tax efforts of the government during these years. It is quite disheartening to note that the ratio

has nearly remained stagnant during the period of our study. In the light of the above finding, we may conclude that the States had neither put in extra efforts in raising its own tax revenue in a much more efficient way nor had it made any sincere effort to tap more resources during the period covered by our study. We believe, this might have been one of the factors responsible for the explosive cycles of public expenditure growth.

From the above findings, we may be tempted to draw two inferences. First, in the absence of any cohesive additional domestic resource mobilization programmes, financing of ever increasing public expenditure has led to the dependency syndrome of the State on the Centre for higher grants-in-aid. Secondly, the non-existence of a vibrant tax structure in order to finance the increased volume of public expenditure has placed the State at the mercy of market forces in terms of public borrowings. Judged from the angle of sound fiscal ethics, the performance of the State government to this effect seems to be unreasonable.

In order to find out the extent of dependency of the State on the contribution of Central taxes, an analysis of the shared taxes in the total tax revenue of the State revealed that the shared taxes have increased in both the states on an average from 30.02 per cent in the year 1972-73 to 71.85 per cent in the year 1998-1999. A striking feature of the State's taxation as revealed by our analysis was the phenomenal increase in contribution of the shared taxes to the total tax revenue of the State. It was observed that over the years, there has been a continual outpacing of the State's own tax revenue by the shared taxes. This indicated that the relative importance of the State's own taxes has been much less than it has been in the case of shared taxes as a component of total tax revenue of the State during the period of our study. As a result, the States have cut a poor figure with regard to the efforts put in by it during the last thirty years of our

study to mop up additional resources from its own sources. The increasing dependence of the State on the share of Central taxes might partly be due to the ever-increasing pressure of the State on the Central Government to widen the pool of shareable taxes and partly due to the greater in-built flexibility and in-built responsiveness that have been brought into these taxes thereby making them more elastic and buoyant than the State's own taxes.

From the above analysis, one could see the dismal performance of the State governments in generating adequate resources from the sources at its disposal. Hence, an attempt was made to analyze the amount of funds transferred from the Centre to the States in order to find out the extent of dependency of the State on the Union Government. The ratio of Union resources transferred to aggregate State's expenditure was 62.29 per cent in the year 1972-73 which increased to 63.65 per cent in the year 2001-02 for the state of Meghalaya. Whereas, Nagaland's experience shows that this ratio is around 78 percent. The State's share of divisible taxes and duties has increased both in absolute and in relative terms. This trend has brought about a plausible deleterious effect on the growth and sustenance of the resource mobilisation efforts of the States in recent times. Given the level of resource mobilization effort of the States and given its degree of dependence on the Centre, we can hypothesize that the State will continue to depend heavily on the Central transfers, in the years to come unless it goes for an immediate rationalization of its tax structure. Therefore, in the absence of additional means to mop up adequate revenue, the States of North-East are far from the goal of financial self-reliance.

Based on the above exercises, we may be tempted to conclude that, the trend observed from the pattern of the composition of the State's taxes is not at all warranted from the point of view of a healthy fiscal economy. The reverse would have been commendable in the context of the State's

efforts at achieving self-reliance with regard to resource mobilization of adequate resources for implementing several developmental programmes.

The analysis of the average annual growth rates of total public expenditure, net state domestic product showed that over the years, the average annual rate of increase of total public expenditure has surpassed the average annual rate of increase of net state domestic product and per capita expenditure. The extraordinary growth of public expenditure in relation to the net state domestic product may be attributed to the massive involvement of the governments in their over all developmental activities of the state in the presence of a highly expanded service sector and a non-existence industrial sector. In the states where the average annual rate of growth of public expenditure tends to be near about double than the average rate of growth of net state domestic product, raises serious doubt about the productivity and efficiency of the public expenditure programmes in the face of a subsistence agricultural sector and low per capita income.

Further, the analysis on the revenue expenditure exhibited an increasing trend during the entire period covered by our study. When revenue expenditure was taken as a percentage to total public expenditure, it was found that for most of the years, revenue expenditure constituted on an average more than 70 per cent of total public expenditure. This increase of revenue expenditure of the State governments clearly exhibited the pattern and direction of public expenditure whereby the States had failed miserably in building up its capital base for further development. This clearly shows that over the years, a large chunk of public investment has entered into the unproductive channels, as it is evident from its high percentage share in net state domestic product.

The analysis of capital outlay as a percentage of total

public expenditure enabled us to find the trend of public investment taking place in the States during the period of our study. It was observed that capital expenditure on an average constituted less than 30 per cent of total expenditure for most of the years covered by our study. A distressing feature that emerged from the analysis was the declining trend of capital expenditure over the years. This only proves that the State has not been able to pursue expenditure policies in consonance with the achievement of long term goals and objectives.

The analysis of the pattern of public expenditure in the State of Meghalaya, based on the sector-wise analysis of revenue expenditure indicated that the expenditures on social services accounted for the maximum annual compound rate of growth of 15.93 per cent while the general services recorded 15.78 per cent and the economic services showed 13.41 per cent. The above growth rates indicate that the revenue expenditures on social services account for the maximum rate of growth followed by the revenue expenditures on general services and economic services. This has resulted in a disproportionate growth of the service sector. The disproportionate growth of the social sector has not only absorbed most of the public investment funds over the years, but also has given rise to a weaker linkage between the different sectors of the economy. The weak linkage is not a healthy sign from the point of view of sustainable economic development and also from the point of view of domestic resource mobilization. Similarly, the exponential growth rates of the sector wise revenue expenditure in the context of Nagaland exhibits that the state does not markedly differ from the state of Meghalaya.

From the above findings, it is clear that, as an instrument of resource mobilization, fiscal policy in general and the taxation policy of the State Government in particular has not been a remarkable success. From the available evidence,

it is seen that taxation policy of the State both through its direct and indirect tax front has not able to bring about any significant increase in the overall resource mobilization programme to meet its ever increasing public expenditure programmes. As a result of which the dependence of the state on the centre is on the increase in recent years.

In this Section, an attempt is made to suggest certain policy implications in the light of the foregoing findings. So far our analysis exhibited a poor elasticity and buoyancy coefficients for the entire tax system of the North-Eastern states. The results no doubt support the state's inability to mobilize adequate resources internally for its various developmental purposes. To overcome the existing deficiencies, we hope the following policy prescriptions may help the state government to certain extent.

It is always possible to devise a suitable system of taxation where the existing weakness can be removed.

Taking into account the above factors, it is possible to suggest the following considerations for evolving a suitable system of taxation.

Given the high proportion of consumption expenditure in total State Domestic Product, the relative share of Government revenues has to be increased mainly by impinging upon consumption activities. This can be brought about by rationalizing the existing taxes in the indirect tax group. Here, the emphasis will have to be on the concerted efforts of the state governments in devising a tax rate regime, which will take away a reasonable proportion of the incremental consumption expenditure into the tax net. Clearly, therefore, what we argue is that the incidence of taxation should be more on those sectors which, in the development process, enjoy a faster growth of incomes; and the particular instruments of taxation have to be tailored on such a way that they operate in these sectors most effectively.

Policy Implications

Given the basic objectives, the following elements may be mentioned as desirable for being incorporated in a satisfactory policy of taxation:

- In order to make the agricultural sector to bear a certain burden of cost of development, we propose a cess on agricultural land and also a cess on irrigation and power supply.
- The standard settlements should be periodically revised every five to seven years so as to make the agricultural tax system elastic with respect to changing economic conditions, and
- Lastly, we recommend a productivity linked professional tax on the large agricultural land owners. That the tax may be related to the reported annual income minus the cost of production. This to certain extent will help in regulating inter-sectoral flow of resources. As non existence of any tax in this sector facilitates the natural flow of resources between sectors.

On the indirect taxation front, we may stress on the Rationalization of simplification of the tax structure in order to compel it to be more buoyant and elastic than its original level. In this regards, certain measures which needs immediate attention are:

- The tax base of states' excise duty may be expanded by bringing more commodities under its fold. To achieve that, it is required that the state will have to reconsider its policy of prohibition.
- Further to make this tax more responsive and buoyant; we suggest a lower tax rate. Rationalization of tax rate structure may be carried out by substituting two or three tax rates for a number of tax rates.
- Ways have to be found to reduce the number of sales tax rate and levy uniform tax rates in respect of some

important commodities. The number of tax rates should be brought down to at least two or three in the course of next two years and this will no doubt reduce both administrative and compliance costs significantly.

- Measures should be taken to relieve the burden of the tax on inputs through a system of tax credits. And, with better information system, perhaps attempt could be made to extend the tax base to the stages beyond manufacturing on the principle of "value added".
- The sales tax incentives given for industrializations in the state need to be rationalized
- The other two taxes which need to be rationalized are the entertainment tax and stamps and Registration Duty. The levy of the stamp duties at very high rates of 15 to 20 percent has resulted in substantial under valuation of immovable property. This has led to investments in real estates an important source of underground economy. The same amount of tax could perhaps be collected by reducing the tax rate.
- The entertainment tax should be brought under stricter tax compliance in order to make it more buoyant and elastic. Further, we strongly recommend that a relatively greater progressive tax rate may be imposed on all sorts of entertainments and the tax rate may be considered as a percentage of the value of tickets .
- In case of the vehicle tax, we are tempted to make a suggestion that registration fee may be charged as a percentage of the value of the vehicle which should be made progressive. We think that this would bring a greater degree of built-in-flexibility and buoyancy not only to this particular tax but also to the indirect tax structure. The life time registration fee may be scrapped all together and in its place annual registration fee may be introduced.

- Every effort may be made to revise the tax rates of vehicle tax every five years by taking in to account the rate of inflation, the rate of increase in income.
- To make the professional tax as most viable direct tax, efforts should be made to expand the base and to bring more progression to the existing tax rate.
- lastly, we may propose the imposition of a poll tax if it is feasible as a alternative source to mobilize adequate resources for the state. The proposed tax will be a direct tax which will be levied on all the individuals at a flat rate. Since, it will be a tax on the mere existence of individuals and not on any economic base, the market distortion and the tax avoidance will be considered to be nil.

In addition to the above general recommendations to re-structure the North-Eastern region's tax structure, the following specific suggestions are considered to be tax responsive and tax buoyant.

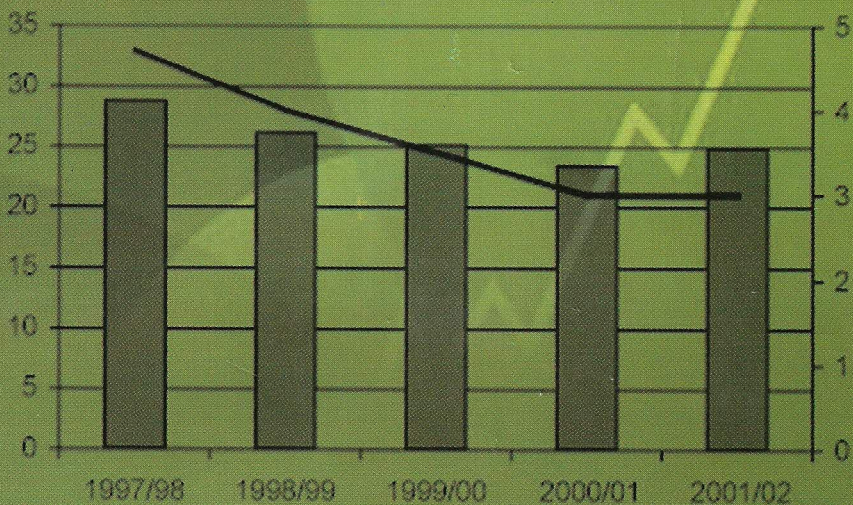
Given the fact that in recent years, North-East economy is flooded with imported goods of all sorts from the neighboring countries, we strongly recommend:

- Import duty may be levied on all types of imported electronic goods, woolen blankets and materials, garments, dry fish, melamine products, footwear, imported soft drinks and cosmetics. This not only checks the flourishing parallel economy but also help in additional mobilization of resources to the state's exchequer.
- A levy in the form of additional user charges may be levied on two wheeler, four wheelers, tires and tubes, lubricants and other automobile spare parts.
- Toll gates may be made more vigilant to make the toll tax more tax yielding. Further, toll tax may be revised and progressivity should be brought in to it.
- An export duty may be imposed on the forest produce such as bamboo and timber.

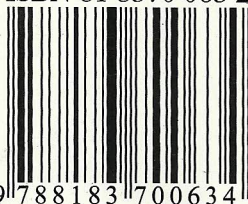
- A high luxury tax may be imposed on the hotels and on long distance buses and Taxis.

We hope that if the above stringent taxation measure will be carried out, the government will be in a position to mobilize adequate revenue so as to bridge the gap in its budget deficits and to reduce its dependence on the centre.

If one were to attempt to compress our arguments in this work into one single argument, then, the problem of state finance has to be treated alongside the problems of societal needs and aspirations, societal attitude, cultural values, institutional value judgment, politics and public administration with a general sense of proportion. It is such an outlook on the part of the political and policy makers that can make it possible for them to come to grips with the problem which demands and will continue to demand attention in the state scene at all times to come. Formulation of fiscal policies should not be left to the political gimmick of the political parties that stay in power, but it should be left to the grounded realities of social and economic aspirations and concerns of the masses.



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