## Chapter II

### Problem of the Study and Research Framework

<table>
<thead>
<tr>
<th>Section</th>
<th>Content</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1</td>
<td>Problem of the Study</td>
</tr>
<tr>
<td>2.2</td>
<td>Conceptualizing Fiscal Policy</td>
</tr>
<tr>
<td>2.3</td>
<td>Fiscal terms used in the analysis</td>
</tr>
<tr>
<td>2.4</td>
<td>Objectives and Scope of the study</td>
</tr>
<tr>
<td>2.5</td>
<td>Research design, Methodology and Hypothesis</td>
</tr>
<tr>
<td>2.6</td>
<td>Universe of the study and Tools of Investigation</td>
</tr>
<tr>
<td>2.7</td>
<td>Research questions and contribution to the literature</td>
</tr>
<tr>
<td>2.8</td>
<td>Why Fiscal Policy</td>
</tr>
<tr>
<td>2.9</td>
<td>Fiscal Instruments: Internal devices</td>
</tr>
<tr>
<td>2.10</td>
<td>Review of literature</td>
</tr>
</tbody>
</table>
Chapter II

Problem of the study and Research framework

2.1. - Problem of the study:

The most diversified State in the North East India with a geographical area of 22,327 sq.kms, Manipur shelters a population of 27,21,756 as per the census 2011\(^{19}\). The State has 352 kms. International border with Myanmar on the south and 502 kms. Long border with Nagaland on the north, Cachar District of Assam on the west and Chin Hills (Myanmar) and Mizoram on the south Surma Tract and upper Chindwin of Myanmar on the east. Manipur can be described as mini-India. It has rich flora and fauna. There are 7 (seven) scheduled castes communities and 33 (thirty-three) different scheduled tribes of different ethnic groups constituting complex socio-economic phenomena\(^{20}\). There is division in the public living in the hills and in the valley, an apparent disparity in the level of income and consumption between the haves and have-nots, comprising of five districts in the hills and four in the valley.

---


The fiscal health is very weak and there is lack of development in the state economy. The most important reasons behind the backward nature of Manipur’s economy can be attributed to outdated method of production in agriculture, poor land reforms, and under-utilization of resources, lack of industrialization, lack of infrastructure, unemployment problems, and low level of technology, excessive pressure of population on agricultural areas and above all the lack of modern marketing facilities. Investment in the key sectors is the present requirement for economic development. Both the government and private individual have less interest and lack of willingness and there is absence of favourable investment climate. It becomes a discomfort to hear and to see the expenditure and the rate of returns on the basic infrastructure like power generation, development of transport and communication, agricultural and industrial overhead facilities. The returns are very low and occurred after long interval. Hence, the responsibility has to be borne by the government of Manipur, which in turn, requires a massive expansion in public expenditure.

On the revenue sides of the government, the State government cannot raise adequate tax and non-tax revenues. State’s own revenues (Tax and Non-tax) are very low compared to other States of the economy. In the advanced state and advanced economy, the capacity to pay the tax is very high. Their sources of income are complex and are from different sectors of the economy. However, in the context of Manipur’s economy, it shows the
dependence on central transfers. Above all, the existence of revenue deficit of the state government due to low revenue and was not able to meet its revenue expenditure and therefore the current obligations are met through borrowing. Although, the state has persistent revenue deficit in the past, it has decreased from Rs.161 crores in 2001-02 to Rs.87 crores in 2002-03 and further to Rs. 44 crores in 2003-04. The substantial increase in the central transfers to the state makes an improvement in the revenue deficit and the other fiscal variables of the state. It makes the research to find out the state own sources of revenue. The political-cum-bureaucratic relationship between the centre and state has been determining the condition of fiscal health of the state. The state cannot make and should not expect all time goodwill from the centre. The Net State Domestic Product (NSDP) at current prices for the year 2009-10 is estimated at Rs.7693 crores as compared to Rs.6,819 crores for 2008-09. Per capita income at current prices is worked out to be Rs.28,276 in 2009-10 as compared to Rs. 25,539 in 2008-09 indicating an increase of 10.72 percent. The net per capita income of the state cannot reach the all India average. The per capita income of Manipur was 18,640 and the all India average was 24,095 in the Fiscal year 2004-05. It rose to 28,276 and corresponding India average is 43,749 in 2009-10 as shown in table 2.1 below.
Due to lack of experience and common commitment of the government officials and ministers, plan money could not be utilized properly. Every financial year the state government used to surrender plan money to the central government. It shows inefficiency in financial management in the State. On the other hand, State’s own revenue is also very low and cannot meet revenue expenditure of the state.

### Table 2.1

**Net Per Capita Incomes at Current Prices**

<table>
<thead>
<tr>
<th>Year</th>
<th>Manipur</th>
<th>Annual Growth Rate</th>
<th>All India</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004-05</td>
<td>18640</td>
<td>------</td>
<td>24095</td>
</tr>
<tr>
<td>2005-06</td>
<td>20404</td>
<td>9.46</td>
<td>27183</td>
</tr>
<tr>
<td>2006-07</td>
<td>21401</td>
<td>4.89</td>
<td>31080</td>
</tr>
<tr>
<td>2007-08</td>
<td>23,089</td>
<td>7.89</td>
<td>35,430</td>
</tr>
<tr>
<td>2008-09</td>
<td>25,539</td>
<td>10.61</td>
<td>40,141</td>
</tr>
<tr>
<td>2009-10(AE)</td>
<td>28,275</td>
<td>10.72</td>
<td>43,749</td>
</tr>
</tbody>
</table>

**Sources:**

2.2. - Conceptualizing Fiscal Policy:

In common parlance, fiscal policy means financial policy of the government for a particular year. However, in economics it has meaningful significance, bigger views and expression. The term fiscal policy is derived from an old Greek word, which means basket and symbolizes the public purse. The word “fisc” meant the treasury, in the Renaissance Italian.

Fiscal policy is the macroeconomic policy of the government regarding revenue policy, public expenditure policy, public debt and financial administration. Fiscal policy or budgetary policy consists of steps and measures, which the government takes, both on the revenue and expenditure sides of its budget. UN Report on taxes and fiscal policy says, “Fiscal policy is assigned the central task of wresting from the pitifully low output of underdeveloped countries sufficient saving to finance economic development programmed and to set the stage for vigorous public investment activity.”

Mrs. Hicks says that “Fiscal policy is concerned with the manner in which all the different elements of public finance, while still primarily concerned with carrying out their duties (as the first duty of a tax is to raise revenue), may collectively be geared to forward the aims of the economic

---

policy”. According to Weeks and Patel, “Fiscal policy includes taxation and expenditure policies of the central government, which are normally implemented by the ministry of finance.”

Fiscal policy in the words of Nurkse, “assumes a new significance in the face of the problem of capital formation in underdeveloped countries.”

“Fiscal policy relates to the government decision-making with respect to (1) taxation (2) government spending (3) government borrowing and (4) the management of public debt. Tax policy relates to government decisions which influence the degree and manner in which funds are withdrawn from private economy. Expenditure policy involves decisions which influence the flow of funds from government into the private economy. Debt management policy refers to the government decisions made with respect to the stock of government debt outstanding and involves decisions as to the types of issue to be marketed, their maturity distribution, and the rate of interest to be paid upon them. Basically then, fiscal policy in these different facets deals with the flow of funds out of the private spending and saving stream into the hands of government and the flow of funds from government into the private economy”.

---

22 Hicks, U.K. - Public Finance, Cambridge Economic Handbook, 3rd Ed. 1968, P-274


Dalton Puts; Public finance is “Concerned with the income and expenditure of public authorities, and with the adjustment of the one to the other …….”26 Arthur Smithies defined fiscal policy, “a policy under which government uses its revenue and expenditure program me to produce desirable effects and avoid undesirable effects on the national income, production and employment”27

Keynes regarded fiscal policy “as a balancing factors”28 which would “bring about an adjustment between the propensity to consume and inducement to invest.”29

Richard, C. Lipsy, “ Government can through their spending and taxing policies, have major impacts on GNP and on employment. The use of these policies in order to influence employment and national income is called fiscal policy.”30

Anyaduba define fiscal policy as “that aspect of government policy that deals with the raising of revenue through taxes and other means and also with decisions relating to the level and pattern of government expenditure”.31


29 Keynes, J.M., ibid., p.379.


Anyanwu states that, “Government………………. Manipulated fiscal operations so as to arrive at a fiscal surplus and convince the international financial institutions that its fiscal position is healthy.”

Therefore, Fiscal policy refers to those aspects of government policy which is concerned on the raising of government revenues through taxation, departmental receipts, profits of public enterprises and borrowing on the one side, and government expenditure of different types such as public consumption and investment, transfers payments and management of the resources on the other.

Fiscal policy involves the use of government spending, taxation and borrowing to influence the pattern of economic activities and also the level and growth of aggregate demand, output and employment. Fiscal policy entails government’s management of the economy through the manipulation of its income and spending power to achieve certain desired economic objective amongst which is economic growth.

---


2.3. - **Fiscal terms used in the analysis:**

1. **Capital Expenditure** - Any expenditure other than operating expenditure, the benefits of which extend over a period of time exceeding one year. It is expenditure on the creation of assets.

2. **Capital Receipt** - Capital receipts consist of borrowing and other liabilities as well as recoveries of loans. Capital receipts create liabilities or reduce assets.

3. **Discretionary fiscal policy** – Deliberate changes in tax rates or the level of government expenditure in order to influence the level of Aggregate demand and employment.

4. **Debt Sustainability** – It is defined as the ability to maintain a constant debt-GDP ratio over a period of time. It is disturb when the debt to GDP ratio reaches an excessive value.

5. **Debt Swap** - To decrease or to finished the Debt amount through exchanging the high interest to low interest loans. Debt Swap scheme was introduced by Government of India to retire the high cost borrowings of the Stare Government through low cost borrowings.

6. **Fiscal capacity** – It refers to the ability of a government to raise revenues and concerns the ability of an individual to pay taxes.

7. **Fiscal consolidation** – The target to remove fiscal deficit through raising more revenue and spending less.

8. **Fiscal federalism** – Fiscal federalism deals with financial arrangements and their working in a federal polity.
9. Fiscal drag – The tendency of automatic fiscal stabilizers to reduce the recovery of an economy from recession. Fiscal drag develops when full employment national income measured in current rupees rises due to inflation just as it develops when full employment national income measured in constant rupees rises due to economic growth. Taxpayers are pushed into higher income bands (higher rates) because of increasing money income (in a period of inflation) which in real terms may remains the same. The higher rate of tax may lead to reduction in real income owing to this fiscal drag.

10. Fiscal policy refers to the use of a government’s taxation and expenditure policies to influence the level of economic activities at the macroeconomic level.

11. Fiscal stance – It refers to whether it is pursuing an expansionary or contractionary fiscal policy. (How expansionary or contractionary the budget is)

12. Grants – Grants are unilateral transfers from one level of government to another lower level of government.

13. Gross Fiscal Deficit - The Fiscal Deficit (FD) is a measure of the extent to which the Government spends beyond its means by resorting to borrowings and becomes indebted in the process. It is defined by the CAG as Revenue Expenditure + Capital Expenditure + Net Loans and Advances - Revenue Receipts - Miscellaneous Capital Receipts.

15. Levy – It is synonymous with tax.

16. Octroi – Tax imposed on the entry of goods into a local area for the purpose of consumption and sale.

17. Outstanding debt – The unpaid loans of the government which is increasing in a developing economy.

18. Revenue deficit – The excess of revenue expenditure over revenue receipts.

19. Revenue expenditure – It refers to all those expenditure of the government which does not result in the creation of physical or financial assets.

20. Revenue receipts – Money obtained in the normal course of business are called revenue receipts. Revenue receipts are normally of recurring nature and are not meant for specific purpose.

21. Solvency refers to the government’s ability to service its debt without defaulting. It is defined as the condition that the state government’s net stock of debt does not exceed its ability to pay off that debt at some time in the future (measured by the present discounted value of its future primary surpluses).

22. VAT – Value added tax is levied on the sellers of goods and services based on value added by their respective units. The base of VAT is determined by value added at a particular stage of production or distribution.
2.4. - Objectives:

The present study deals with the fiscal scenario of the Manipur economy. Besides analyzing past behavior, present position and future prospects of fiscal development in the state, it suggests a development strategy by implementing the fiscal instruments in the state economy. The fiscal policy, for a year or a particular period reflects the budgetary pattern of the economy which gives a complete picture of the estimated receipts and expenditure of the government for the year. The instruments of fiscal policy, namely public revenue, public expenditure, public debt and financial administration play a great role for the economic development of an economy. The financial resources of the economy can be channelized in the right direction by an appropriate fiscal policy reforms and measures.

We have learned the lesson from the advanced countries, the technique and instruments they used for their economic development. Manipur is now in a critical juncture in all its aspects, and financial problem or misleading of finance is a particular case. It is against this background that the present study attempts to examine and analyze some of the important aspects of fiscal policy and its relevance in the state economy. So, the enquiry seeks to examine the financial situation and future economic development of Manipur.

The specific objectives of the present study are as follows:

1. To analyse the role of fiscal instruments in general and its adaptation in Manipur in particular.
2. The analysis of State’s revenue; Sources, Taxable capacity, a good tax and Tax-GSDP ratio in Manipur.

3. To analyse the trends of public expenditure and suggest the right direction of public expenditure in the State economy.

4. Analysis of public debt and financial administration in the state economy.

5. Analysis of fiscal failure or imbalance (revenue vs. expenditure) in the state economy.

**Scope of the study:**

Fiscal policy tends to cross the budgetary pattern of the State. It becomes the exercises of the state government for many policies and programmes with relates to finance and for the economic development of the state while analyzing the functional constraints of the policy for economic development. It becomes necessary to have a broader sight of public expenditure and other ways of resource mobilization from the institutional and government machinery.

The scope of the study is not only to analyse the source of income and the way of spending of the government but also to examine the economic development of the state. Economic development relates to increase in GSDP, increase in welfare and structural changes in the economy. So, the analysis of government revenue and expenditure policy for increasing state domestic product and for social welfare is also a part of the study.
On the basis of the above specific objectives, the study of “Fiscal policy: with reference to 21st century Manipur’s Economic Development” (2000-2010) is presented broadly consisting of seven chapters. The First Chapter is Introduction dealing the theoretical development of fiscal policy, the importance and relationship of fiscal policy to other socio-economic policy. The Second Chapter includes problem of study and Research framework consisting of methodology, main objectives, Fiscal instruments and Review of literature.

The Third Chapter deals with the sources of public revenue in Manipur. There are three sources of state’s revenue, namely State own tax revenue, own non-tax revenue and central transfers. Sources of tax revenue consist of income tax, sale tax, excise duties, land revenue, registration fees, goods and services tax etc. State’s own non-tax revenue comprises the income from public enterprises and public undertakings and others own non-tax revenue receipts. The central transfers to the state are coming through three channels, (a) Finance commission’s transfers, (b) Planning commission’s transfers and (c) Departmental or discretionary transfers.

The Fourth Chapter covers the trend, volume of public expenditure. An analysis of expenditure policy in the state for economic development is the main focus in this chapter. The right direction of expenditure should be considered to find out the proper area and proper sector of the economy. As for example, in an economy there are three sectors that is primary sector, secondary and tertiary sector. These three sectors made considerable share to
the GSDP. A relative comparison between the revenue earned and expenditure to be made is required for the analysis. So, we can find out the particular sector that generates more revenue with compared to the expenditure made and vice versa.

The Fifth Chapter is the analysis of public debt and financial administration in the State. Development is the result of sound financial system and sound financial system is the result of good governance and administration. Economic development and financial development are directly related to each other. Financial development is also depends on the agencies of financial administration. Agencies like the legislative committees, the finance department of the finance ministry and the audit play a great role in the management of finance. The detail analysis of budget content and context, the preparation, execution and enactment of budget are also related to the management of finance.

The Sixth Chapter deals with the fiscal imbalance between the receipts and expenditure. The mismatch between the receipts and expenditure can be analysed by using statistical method. Statistical method like correlation, regression, averages and diagrams etc. will be employed in this chapter.

The Seventh Chapter is the summary and conclusion of the study. It includes the main findings, suggestions and prospects of the study.
2.5. - Research Design and Methodology:

The methodological discipline will start with the existing secondary data like summaries, journals, different research papers, bibliographical works, general works, specialised works and reports from government sources, diaries, manuscripts and related records of finance department concerning the economy. The collected material will be examined and presented with an analytical outlook of the objectives, approach and contents of this proposed research study, with a view to deriving the basic framework of hypothesis and references.

A method of analytical and formulative-research is applied in the present study. The objective is to gain familiarity with a phenomenon or to achieve new insights into it. In this type of research the emphasis is not on finding exactly the cause – effect relationship but mainly on the analysis of the impact, contribution and transformation aspects with the help of relevant indicators especially formulated for this purpose by the researcher. The people of Manipur are facing many problems i.e. lack of finance, lack of industrial location, lack of raw material, bottleneck of transport and communication, low standard of living, crime and corruption, lack of education, lack of advanced administrative mechanism and ethno-social problem etc. It is the right direction and proper fiscal policy-reforms that could bring our economy to the path of development. And above all,
analytical synthesis and forecasting adjustment maps-data for the sake of future will be constructed as an essential part of this study within the sphere of the economy of Manipur.

Hypothesis: The following hypothesis is made.

1. The fiscal health of the State is weak.
2. Government cannot collect adequate revenue.
3. The direction of government expenditure is not in right way for the development in the State.
4. There is mismanagement and maladministration in respect of finance.

2.6. - The universe of the study:

The research is to analyze the fiscal scenario of the State economy and is expected to be the universe of the study. It covers the role of fiscal instruments in the economic development of the state economy. The nature of investigation shall be the government of Manipur, Manipur economic development and various departments of the state regarding its income and expenditure.
**Tools of investigation and Sources of data:**

It is based on the secondary data already published by the various departments, government of Manipur. It is the data based on;

- The publications made by finance department, Government of Manipur.

- The finding of planning commission and finance commission.

- Other published literature, bulletins and publications of various department.

The estimates of public expenditure and public revenue of the state government have been compiled from the details available in the budget documents, finance department and the department of planning commission of the state government. The budget documents of the central and state government contain data on receipts and expenditure for the three years i.e., the budget estimates for the next years, the actual estimates for the previous year and the revised estimates for the current year. While analyzing the budget documents, receipts and expenditure are classified into capital and revenue account i.e., capital receipts and revenue receipts. Likewise, there is capital expenditure and revenue expenditure on the expenditure side. It is very interesting to analyze the tax and non-tax revenue of the state government. Taxes are land revenues, stamps and registration fees, sale tax, state excise, taxes on vehicles, taxes on electricity, profession tax, other taxes on goods etc. The non-tax revenues of the state are:
1. Interest receipts
2. Public works
3. Police
4. General services
5. Education, sports, art and culture
6. Medical
7. Public health
8. Social services
9. Forestry and wild life
10. Power

2.7. - Research questions:

For the achievement of the above-mentioned objectives in the previous section, the research has to analyze and answer the following question.

1. Is the public expenditure on the right direction?
2. Can the government raise more revenue for meeting the expenditure?
3. Is there any relevance between the fiscal policy and economic development?
4. Is the government managing the finance in a proper way?
5. How the fiscal health of the state and what is the policy strategy for improvement?

Contribution to the literature:

The present study will provide a more up-to-date analysis of the efficacy of fiscal policy in the state economy of Manipur. This work focuses
on the behavior of government expenditure, public revenues, State Debt and financial management.

A published sample data is analyzed, using the yearly data from 2000 through to 2011. However, it is necessary to highlight that Manipur’s economy has been subjected to structural changes over the time. From the first five year plan (1950-51) through the present 1st decade of the 21st century (2000-10), the economy was performing its fiscal instruments for economic development.

2.8. - “Why Fiscal Policy”, the Objectives in the Economy:-

1. Resource Mobilisation:

   The revenue of the government can be raised through taxing and from the income of government enterprises. If it is not sufficient, borrowing activities can be made.

2. Equitable distribution of income and wealth:

   For socio-economic justice, government should allocate and redistribute the resources with the use of fiscal instruments.

3. Economic growth:

   It is one of the most important objectives of the fiscal policy. For more production and generation of productive capacity, the initiative role is the government.
4. Modernization:

The aim and object of every economy is to become modern civilized society. For modern and advanced amenities, fiscal policy plays an important role.

5. Employment generation:

To give employment to the unemployed individual is also another target of the fiscal policy. Government is initiating many employment generation programmes and schemes and for that certain amount of investment had been done.

6. Direction of expenditure and investable resources:

It is the specification of sectors, the right area of the expenditure for more generation of income and employment.

2.9. - Fiscal Instruments: Internal Devices:

Fiscal instruments are the devices used in fiscal policy. As we have already mentioned that fiscal policy is the policy of the government regarding collection, distribution, stabilization and concerned on the development of the economy. Now a day, fiscal instruments play a greater role for the right direction of the economy. Fiscal instrument has certain role for certain economic problem. The crux of a good and effective fiscal policy lies in keeping its instruments like taxing, expenditure, subsidy and financial management in a proper balance for the objectives of the
economy. Taxation, expenditure and financial administration are the important internal devices of fiscal policy in an economy.

**Tax policy**

Tax policy points out the manner in which funds are withdrawn from consumers and producers of the economy. It is a highly powerful instrument of the government to affect changes in disposable incomes, consumption and investment. “The major concern of tax reformers has been the need to improve the equity of the tax structure so as to make it comply more nearly with prevailing views of what constitutes a fair distribution of the tax burden and with the effect of taxation upon the functioning of the economy”\(^{34}\). For a good tax and tax policy we need to consider the tax legislation and tax administration. What tax laws to be passed and how to manage the tax collection for maximum benefit of the society are the questions to be answered. The detail analysis will come in the public revenues chapter.

**Expenditure policy:**

It is the government distribution of funds to the economy. It points out the flow of funds from the government to the private economy. In this regard, the German fiscal expert Adolph Wagner opined that, “comprehensive comparisons of different countries at different times show that, among

---

progressive peoples, with whom alone we are concerned, an increase regularly takes place in the activity of both the central and local governments. This increase is both extensive and intensive: the central and local governments constantly undertake new functions, while they perform both old and new functions more efficiently and completely." 35 It becomes one of the powerful instruments for performing the business of the economy. With the increasing expenditure on the one hand and the need to select the right direction of expenditure on the other has become an important issue to be considered at the present moment.

Financial administration:

Financial administration is the management of the finance and resources of a state or a public authority endowed with taxing and spending power. Development is the result of sound financial system and a sound financial system is the result of good governance and administration. Economic development and financial administration is related to each other. Financial development is also dependent on the agencies of financial administration. Agencies like the executive, the finance department of finance ministry, the audit department and parliamentary committees play an

important role in financial administration. In fact, public finance is an integral part of financial administration.

Fiscal management is a continuous and dynamic process involving a continuous chain of operations. Fiscal management includes, as its principle subdivisions, budget-making followed by the formal act of appropriation, executive supervision of expenditure, the control of the accounting and reporting, revenue collection and auditing. According to Goode (1984)\textsuperscript{36}, fiscal instruments can be categorized into two groups:

1. Instruments representing receipts

   * Taxes
   * Fees and income from state property and enterprise
   * Proceeds from the sale of government assets
   * Grants from other governments
   * Borrowing and creation from central bank
   * Money creation through the coordination between fiscal and monetary policies

2. Instruments for expenditure

   - Purchases of goods and services
   - Transfer payments
   - Lending including the acquisition of financial equities.

\textsuperscript{36} Goode, R. - Government Finance in Developing Countries, Washington D.C., The Brooking Institution, 1984, P. 3-5.
2.10. - Review of literature:

Seligman (1908), asserted an important idea put by the Mercantilists on fiscal principle. The Mercantilists idea was that men should be taxed according to the benefits they received from the state. The duty for the state is to protect the nation, it requires expenditure and it comes from taxation.37 Petty, the first English writer on fiscal attitude forwarded, “it is generally allowed by all that men should contribute to the public charge but according to the share and interest they have in the public place; that is according to their Estate and Riches.”38 In general, the Mercantilists put the idea of fiscal operation on the benefits the people received and the test for benefit should be expenditure.

According to Lerner (1951), the volume of employment depends on the rate of spending. He has given more important on expenditure side of the fiscal policy. There are five elements in the total spending of an economy. They are consumption by the individuals, consumption by the government, investment by the individuals, investment by the government and investment by the private individuals. Any policy for full employment has to work on one


or multiple of these five elements which make up the total spending on currently produced goods and services. In addition, he mentioned the government’s three fiscal weapons for fighting deflation. By increasing government expenditure directly for own purchases or indirectly to spend money for social security’s benefits to people who will spend it and less taxes from the individuals so that they can spend more.39

Lipsey & Steiner (1978), there is little doubt that, when appropriately used, fiscal policy can be an important tool for influencing the economy. In the heyday of fiscal policy in 1940s, 1950s and 1960s, many economists thought that the economy could be adequately regulated solely by varying the size of the government’s deficit or surplus. That day is now past, although a few “pure fiscalists” are still to be found. The role of fiscal policy in the economy and its employment by the economists are increasing day by day. When Milton Friedman said, “we are all Keynesian now”, he was referring to the general acceptance of the view that the government’s budget is much more than just the revenue and expenditure statement of a very large organization. Whether we like it or not, the very size of the government’s budget inevitably makes it a powerful tool for influencing the size of the GNP and total amount of employment in the economy.40

Victoria (1983), mentioned that, “Keynes spoke of public work; Keynesians speak of fiscal policy. The term public work connotes

government expenditure undertaken in special circumstances, as distinguished from regular expenditure. Fiscal policy encompasses both government expenditure, the expansionary side of fiscal policy, and taxation, the restrictive side since both have a role in stabilization policy, the broader term Fiscal policy came into used.\footnote{Victoria Chick, - *Macroeconomics After Keynes-a reconsideration of general theory*, Cambridge, MA:MIT Press,1983, p.318.} The use of fiscal policy measures for the purpose of promoting growth and stability for efficient allocation of resources and economic equality came to be recognized during the Keynesian revolution. Advanced countries and developed economies profitably used fiscal policy to achieve development and effective allocation and distribution of resources.

Guhan (1984) in his study of Devolution criteria, has attempted at an evaluation of the criteria used by successive finance commissions and currently by planning commission in mediating resource transfers from the centre to the states and has explored the lines along which a practical approach could be evolved to frame a devolution formula for the finance commissions and a complementary policy for plan transfers. In his finding, the strength of Indian centre state financial system is that it provides mechanism in the finance and planning commissions, which can redistribute national resources between centre and states in the light of ability and need of the latter. The weaknesses on the other hand, has been a lack of both clarity and co-ordination in regard to ways in which the finance and planning
commissions could address themselves to upgrading ability while responding to the needs and to compensation for backwardness of the states.\textsuperscript{42}

Chowdhury (1986) in his study in Bangladesh economy, regarding the fiscal and monetary impacts on economic activity, the fiscal policy action had greater influence on economic activities than monetary policy. In an underdeveloped and developing economy, fiscal policy plays much bigger role than the monetary policy.\textsuperscript{43}

Virmani (1990) in his study has tried to both qualify and quantify the size and role of government intervention in the working of the Indian economic machinery. He mentioned that the role of government in the economy has expanded enormously since independence which is shown by precise qualitative measures given in the national income accounts, on both the production, income generation side and the expenditure side. These measures though direct, understate the role of the government. Virmani explains that the indirect role of the government is however multifaceted though difficult to quantify. The quality of government intervention in the economy has also come to be increasingly questioned. The methodology used by Virmani to analyze the size and role of government with respect to quality and quantity is simple analysis of the size of the government in the past independence period, the growth of government (1960-1984), in public

\textsuperscript{43} Chowdhury, A.R. - \textit{Monetary and Fiscal Impacts on Economic Activities in Bangladesh, A note}; The Bangladesh Development Studies, XIV (2). 1986, P 101-106
investment, public consumption, consumption by various levels of government and consumption by purpose categories. The conclusion was that the government’s role in economic activity has increased phenomenon ally since independence.44

Hemlata Rao (1994) in the study of centre state financial relation suggest that there should be transfer of resources from the centre to the state as the existence of fiscal imbalances and, at the same time, some states require more assistance. The argument is that resource transfer should be based on a principle of need. Besides need, derivation has also been one basis for the transfer of resources from the centre to the states. According to the principal of derivation, states should be allowed a share in the divisible taxes and duties, on the basis of their contribution to the central exchequer.45

Kaur (1996) in his analysis of relative effectiveness of fiscal and monetary policy in Indian Economy has highlighted that the fiscal policy has been more important than monetary policy in the country. In his empirical analysis based on actual data over the periods of four decades from 1960s to 1990s, he uses the multiple regression to test the relative effectiveness of the above two variables and the comparison of the coefficient of both the variables determine the relative strength of the policies on economic activity.

Though monetary policy of a country has to closely co-ordinate with the fiscal policy, the outcomes of kaur’s study is that fiscal policy influences are stronger, faster and more predictable than the monetary policy influences which is attributed to the fact that underdeveloped financial markets and existence of uninformed credit markets limit the working of monetary policy in India.46

Bajpai and Sachs (1999) examined the situation of state finances in India. They find that reform of the state fiscal system is necessary in order to reduce expenditure and making more revenue. The inefficient intergovernmental transfer mechanism in India is responsible for fiscal indiscipline at the state level.47

Drazen (2000) in his analysis of Political economy in Macroeconomics indicated that redistribution of income was one of the most important elements to any discussion on fiscal policy, particularly on the issue of taxation. The expenditure side of the government, it is true and practical, that the various government program me have strong redistribution implication.48

Shome (2000) in a policy review in centre-state financial relations on the ground of an inverse relationship between decentralization and fiscal

deficit; decentralization in expenditure leading to higher economic growth and reduce fiscal deficit of the states. In these regard, shome suggested a reduction in the share of overall revenue transfers in the central taxes from the centre to the state, which according to him will leave greater room for the states to collect their own revenue, “giving them more responsibility to handle their own affairs”. He argues that the drain on the states’ financial resources emanated from extensive subsidies and the reduction in non-tax revenues including user charges on the provision of electricity, road transport and irrigation. Overall the quality of states’ fiscal performance, reflecting both revenue and expenditure heads, had worsened significantly during the decades of the 1990s. \(^{49}\) Rajaraman and visistha (2000) in their study on Impact of Grants in the districts of Kerala, find that an increase in non-matching grants to local bodies affects the tax effort negative returns. They have arrived the negative relationship between tax efforts and grant with the assumption that population size represents tax capacity.\(^ {50}\)

The persisting deterioration in fiscal health has prompted the states to introduce fiscal measures, institutional reforms and sectoral measures to achieve fiscal stability and sustainability. Fiscal measures broadly cover the adoption of fiscal prudence by containing unproductive expenditure and mobilization of resources through improved enforcement of tax laws.


Institutional reforms, though they differ across states, broadly emphasize improvement in efficiencies of public sector units, transparency in state budget, restructuring of the irrigation and co-operative sectors, administrative reforms, decentralization and extensive computerization. The sectoral measures basically aim at increasing the output of various sectors; they address growth in agriculture, provision in infrastructures and setting up of specific economic zones to attract foreign investment, and promote industrial and service sector investment and output activities. Overall, to mobilize adequate resources, an effort has been made by some states to rationalize user charges of public services and to contain expenditure and restriction have been imposed on fresh recruitment.\textsuperscript{51}

The IMF approach emphasizes, that “fiscal space can be defined as the availability of budgetary room that allows a government to provide resources for a desired purpose without any prejudice to the sustainability of a government’s financial position”\textsuperscript{52} (Heller 2005: 3). The desired purpose of the fiscal policy is very important where the government can arrange resources and there is fiscal space for it.

John sloman, (2006) in his analysis of the relative merits of changing government expenditure and changing taxes, has given the opinion, “changing government expenditure has the advantage that it affects aggregate demand

\textsuperscript{51} EPW Research Foundation - \textit{Finances of state Governments, Deteriorating Fiscal Management}, Economic and Political Weakly, vol 39 No18, May 1-7, 2004 p1844.

directly and has a bigger multiplier effect. Changes in government expenditure can be more specifically targeted than changes in taxation. For example, government expenditure can be directed to regions of high employment or to the specific sectors, such as transport. Taxes cannot be used so selectively.”

Therefore, the most effective tool of fiscal instruments for a specific purpose is becoming public expenditure.

Ravishankar, Zahir and Neha (2008) in their study, “Indian States’ Fiscal correction: An Unfinished Agenda” have given the three criteria for measuring the strength of fiscal correction. First, the principle of “golden rule” which has wide acceptance in India- the principle that government’s current account must not be in deficit, in other words borrowing must only be undertaken for the creation of productive assets. Second, the requirement of debt sustainability – ensuring that the burden of servicing debt and guarantees do not pre-empt too high a share of the state’s revenue, which requires reducing and containing the Primary (non-interest) fiscal deficit, and controlling guarantees. Third, enhancing its own revenue, this is being used as a proxy for the quality of fiscal adjustment. They also mentioned the requirement of strong political commitment to fiscal discipline for sustaining a good fiscal stance. Where there is a will, there are certainly feasible ways to

---

improve state revenue performance and the expenditure for most effective development in the state.\textsuperscript{54}

Mansouri (2008) in the study of three countries shows the relationship between fiscal policy and economic growth in Egypt, Morocco and Tunisia. The empirical studies showed that 1 percent increase in public spending raised the real GDP by 1.26 in Morocco, 1.15 percent in Tunisia and 0.56 percent in Egypt. He exclaimed that there is long-run relationship between fiscal policy and economic growth for all the three developing countries. So, fiscal policy has performing certain role in the developing countries.\textsuperscript{55}

Kumar and soumya (2010, p13) “A look at the revenue receipts of states shows that there was a steady improvement in the tax ratio during the study period. The revenue from states’ tax receipts as a ratio of GDP was virtually stagnant throughout the 1980s and 1990s at around 7.7%. There was some decline from 1994–1995 and the low point of 7.2% was reached in 1998–1999, the year in which the states had to revise their pay scales, which exacerbated their fiscal problems. The pay revision in 1997–1998 created more fiscal stress for state governments as revealed by the increase in their revenue deficit from 0.9% of GDP in 1990–1991 to 2.6% in 2000–2001. The extent of the stress on state budgets can be gauged from the fact that, since the

mid-1990s, salaries and pensions account for 80–90% of revenue receipts in most states. However, the tax ratio has steadily improved from 7.8% in 2000–2001 and reached 9.6% in 2008–2009. A major development at the state level is the adoption of VAT from 2005–2006. The VAT would help to remove the cascading tax burden. Tax revenue is expected to rise as compliance improves under VAT. The state VAT has evidently helped tax revenues to increase from 8.6% in 2005–2006 to 9.6% in 2008–2009.\(^5^\)

Karimi and Khosravi (2010) have studied the impact of monetary and fiscal policies on economic growth in Iran using autoregressive distributed approach to co-integration between 1960 and 2006. The empirical evidence shows the existence of long-run relationship between economic growth, monetary policy and fiscal policy. In conclusion, they found that a negative impact of exchange rate and inflation as proxies for monetary policy, but a positive and significant impact of government expenditure on growth.\(^5^\)

‘It should also be noted that public sector “institutions” are also likely to affect economic growth. For example, Persson and Tabellini (1992) outline a theory that relates different political incentives and political institutions to growth. They conclude that income inequality is “bad” for growth in democracies, while land concentration is bad for growth everywhere.


Relatedly, there is much empirical work that suggests that factors such as the number of local governments, the presence of tax and expenditure limitations (TELs), and the political composition of the governing party affect (and are in turn affected by) fiscal policies.”

Babalola and Aminu (2012) investigated the impact of both fiscal revenue and expenditure on economic growth in Nigeria. They classified the fiscal expenditure into productive and unproductive government expenditure while direct income tax was used as a proxy for distortionary fiscal revenue. In order to avoid spurious estimates, the unit roots of the series were verified using Augmented Dickey-Fuller (ADF) technique after which co-integration was conducted. The error correction models were also estimated to determine the short-run dynamics. The result in the analysis is that there is long-run positive impact of productive government expenditure on economic growth. Unexpectedly, distortionary revenue positively influenced economic growth. The analysis recommends improvement in government expenditure on health, education and economic services, as components of productive expenditure, to boost economic growth.

---


# Chapter III

## State’s Revenue Receipts

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1</td>
<td>Introduction</td>
</tr>
<tr>
<td>3.2</td>
<td>Tax Revenue</td>
</tr>
<tr>
<td>3.3</td>
<td>Non-tax Revenue</td>
</tr>
<tr>
<td>3.4</td>
<td>Manipur a Dependent State on Centre in Finance</td>
</tr>
<tr>
<td>3.4.1</td>
<td>State Own Tax and Non-tax</td>
</tr>
<tr>
<td>3.4.2</td>
<td>State’s Own Tax</td>
</tr>
<tr>
<td>3.4.3</td>
<td>Comparison of Per Capita Own Tax Revenue of North East States</td>
</tr>
<tr>
<td>3.5</td>
<td>State’s Own Non-tax Revenue</td>
</tr>
<tr>
<td>3.6</td>
<td>Central Transfers to the State</td>
</tr>
<tr>
<td>3.7</td>
<td>Development Vis-à-vis State’s Revenue Receipts</td>
</tr>
<tr>
<td>3.8</td>
<td>Tax Effort and Tax Ratio</td>
</tr>
<tr>
<td>3.9</td>
<td>VAT and Sales Tax</td>
</tr>
<tr>
<td>3.10</td>
<td>A Good Tax</td>
</tr>
<tr>
<td>3.11</td>
<td>Conclusion</td>
</tr>
</tbody>
</table>