A STUDY ON THE IMPACT OF FISCAL REFORMS ON SELECTED FISCAL INDICATORS OF NAGALAND

THESIS SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF DOCTOR OF PHILOSOPHY

NOSEKHOL ALBERT KHIZHO
(Reg. No. Ph.D/ECO/00141 Date 21.08.2017)

UNDER THE SUPERVISION OF
PROF. MITHILESH KUMAR SINHA

DEPARTMENT OF ECONOMICS NAGALAND UNIVERSITY

LUMAMI – 798627

August 2025

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Dedicated to my late Mother - Boni Christina who was the source of my perseverance and to my lovely family Bawihtei, Nana and Sheshe for their patience.

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My heartfelt thanks go to my family for their unconditional love, understanding, and encouragement. To my lady wife Er. R. Zomuanpuii (Muantei) and my two lovely children Florence and George, thank you for your patience, sacrifices, and faith in my abilities. To my friends - Dr. Tovishe Phucho, Dr. Kedovikho Yhoshu, Er. Yanrenthung Ezung, Dr. Maddela Prabhakar, thank you for being my sounding board, for the encouragement to keep going. Your support behind the scenes ensured a smooth progression of my work.

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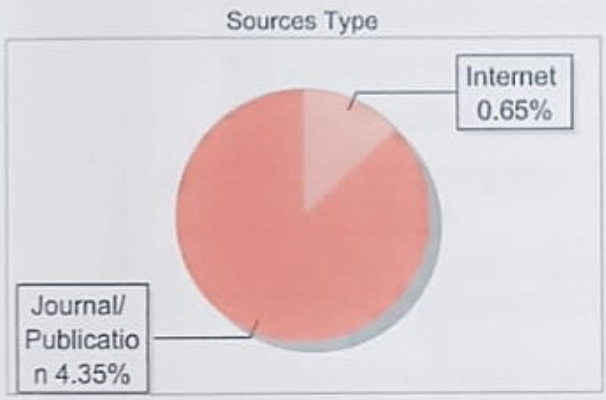

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CONTENTS

ACRONYMS/ABBREVIATIONS

BE	Budget Estimate
CAG/C&AG	Comptroller and Auditor General
CAGR	Compound Annual Growth Rate
CSO	Central Statistical Organisation
DCRF	Debt Consolidation and Relief Facility (Scheme)
FRBMA	Fiscal Responsibility and Budget Management Act
GDP	Gross Domestic Product
GFD	Gross Fiscal Deficit
GNP	Gross National Product
GSDP	Gross State Domestic Product
GST	Goods and Service Tax
NEC	North Eastern Council
NITI (Aayog)	National Institution for Transforming India (Commission/Council)
NSDP	Net State Domestic Product
NPRD	Non Plan Revenue Deficit
OECD	Organisation for Economic Co-operation and Development
PDV	Present Discounted Value
PPP	Public Private Partnerships
RBI	Reserve Bank of India
SCS	Special Category States
SPSE	State Public Sector Enterprises
UK	United Kingdom
USD	United States Dollar
VAT	Value Added Tax

LIST OF TABLES

LIST OF FIGURES

A STUDY ON THE IMPACT OF FISCAL REFORMS ON SELECTED FISCAL INDICATORS OF NAGALAND

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CHAPTER 1

INTRODUCTION

The role of fiscal policy in economic growth has an important place in economic research and economic theory since it provides a framework for understanding and influencing macro economic outcomes. The traditional role of fiscal policy in the classical economic theory is considered to be in fostering sustainable long-term growth through carefully designed tax systems and spending programmers (Hemming, et al. 2002). While the focus of these studies was mostly to identify the level of effects of fiscal policy on growth, more recent literature, however, places increasing weight to the role of expansionary fiscal policy and its potential role in stimulating economic growth (Giavazzi and Pagano, 1990).

Much of the theoretical debate centers around the effects of fiscal expansions on growth where the classical Keynesian theory expects this effect to be positive, and vice versa, fiscal contractions are in this tradition associated with lower growth and recessions. Nevertheless, evidence of expansionary fiscal contraction does exist (Giavezzi and Pagano, 1990), though this is in contradiction with the expected (positive) sign of the fiscal multipliers (Hemming, et al. 2002). Such analysis is of vital importance to many economies where resources are limited for raising current levels of public spending. Two recent exceptions in this direction are by (Devarajan, et al. 1996) and (Gupta 2002).

The study by (Devarajan, et al. 1996) suggests that, for developing countries, switching public spending from investment to consumption type is growth enhancing. It follows that effectiveness of any particular fiscal policy in stimulating. This effect is specially emphasized in the endogenous growth models where capital taxes act to reduce the constant steady state rate of return of privately supplied, reproducible factor of production, and hence the steady state growth rate (Eken, 1997). Growth (or economic activity through e.g. stimulating investment) will depend on the magnitude and sign of the fiscal multipliers.

The role of fiscal policy in the national government's plan, discretionary balance between its outlays and recurring revenues (broadly, spending and taxes) has long been a subject of debate and controversy in modern times. During the 20th century, for a

time at least, a 'Keynesian' view of the role of fiscal policy supplanted the more traditional conservative view. The latter view took as its benchmark a rather thorough-going commitment to the maintenance of a balanced budget aggregate spending being restricted to the size of aggregate recurring revenue with a view to the objective of sound management of the government sector's 'balance sheet'. Or to put the same point differently, budgets were to be framed with a view to prudent management of the State's assets, financial liabilities and net worth generally with a presumption in favour of 'small government'. This approach does not inexorably lead to the policy conclusion that there ought to be continuous annual balancing of outlays and recurrent revenue: it is consistent, for example, with balancing the 'current' budget (recurring expenditures equal to recurring revenues), while funding capital expenditure with issue of financial liabilities (government debt).

For in this way, at least if sensibly done, the value of assets would increase with the extent of financial liabilities, with no deterioration in the public sector's net worth. Nevertheless, in practice the credo of the balanced budget was the common mantra. And in truth, the illiquidity of government assets, and their commonly non-revenue-generating character, means that funding assets with debt is not a straightforwardly viable financial exercise. The role of fiscal policy in developed economies is to maintain full employment and stabilize growth. In contrast, in developing countries, fiscal policy is used to create an environment for rapid economic growth.

1 FISCAL POLICY AND ITS MECHANISM

1.1 The concept of Fiscal policy

The modern fiscal policy defines the basic directions of the use of financial resources of the state, means of financing, and main sources of updating the treasury. Depending on concrete historical conditions in different countries such policy (politics) has its own features. At the same time developed countries use a set of common measures. It includes straight and indirect financial methods of regulation of the economy.

The straightway concerns the means of budget regulation. The means of the state budget are financed:

- Expense on expanding reproduction.

- Unproductive expenditures of the state
- Development of infrastructure, scientific research, etc.
- Realization of structural policy.
- The support of military producers' complexes etc.

With the help of indirect methods State influences on the financial opportunity of the manufacturers of goods and services and the demand sizes of customers. The important role here is the system of taxation. Changing the rates of the taxes on various kinds of incomes, giving tax privileges, reducing minimum tax-free income etc., the state aspires to achieve probably steadier rates of economic growth and to avoid sharp rises and falls in manufacturing. One of the important indirect methods assisting accumulation of the capital is the policy (politics) of accelerated amortization*. In essence, the state exempts the businessmen from paying taxes with part of the profit, artificially redistributes it in an amortization fund. So, in Germany at the beginning of 70 years several industries on amortization[1] were authorized to write off 20-30% of the cost of a fixed capital in one year. In Great Britain, in the first year of the introduction in using of the new instrument, it was possible to deduct from the fund of amortization 50 % of the cost of new instruments of manufacture.

Fiscal policy can effectively influence the future growth rate of the economy by promoting the expansion of human capital stock (e.g. education, health) by investing in infrastructure projects or by strengthening the legal operation framework of the economy (jurisdiction). These expenditures are viewed as productive. The improvement in the quality of human capital and the modernization of infrastructure are extremely important sources of growth for Libya and Turkey, as these factors play a crucial role in promoting FDI investments. The technology spillover from these investments enables a faster catch-up of the transition economy. This evolution in turn allows for rapid income convergence. On the other hand, welfare transfers and state subsidies to industries are considered to be unproductive in the endogenous growth framework.

[1]*Amortization is the process of gradually paying off a debt over a set period of time. It's commonly used for loans, where each payment includes both principal and interest. Over time, the principal portion of the payment increases while the interest portion decreases. This structured repayment schedule ensures the debt is fully paid by the end of the term, and is applicable to a variety of assets, not just financial loans.*

Regarding the revenue side (taxes mainly) endogenous growth theory stipulates that the reduction in those taxes that distort the efficient allocation of production resources (taxes on labour, capital) should stoke higher economic growth. These taxes are considered distortionary, while taxes on consumption are treated as non-distortionary. Therefore, it is their essential interest to adjust fiscal policy in the direction to support economic convergence by choosing the most appropriate expenditure and revenue composition. Nevertheless, finding support for the theory in data is not straightforward at all and it is not just because of the short time series and the less reliable fiscal accounting in the initial phase of transition.

The theory would link the spending level on productive expenditures to faster economic growth. The first and most important thing that we must note is that in the case of productive expenditures the level of spending does not *per se* define the efficiency of the spending.

Therefore, increased absolute spending might not be a true sign of improved efficiency or a drop in expenditure might not simply mean a drop in service quality (this side looks more probable though). These problems are expected to typically occur at the beginning of the transition, when due to high inflation the real value of the expenditure side of the budget drops, as there are no immediate indexations.

However, we can assume that the government sets the overall expenditure side of the budget exogenously, and if we find a permanent shift for higher share of productive expenditures we should consider this as a positive policy move in our analytical framework. This should be naturally true when there is an increase in absolute level of productive expenditures as well.

The second issue is the heterogeneity of productive expenditures. While expenditures that are aimed at boosting human capital consist significantly of labour costs, infrastructure spending is to a much higher extent capital expenditure. These expenditures can have a very different nature in terms of persistence. This is because an alteration in wage-related expenditures should have a more lasting impact than the juggle with investment spending, which usually is one of the first candidates for a cut-back in case of fiscal tightening. This indeed adds significant noise to the data which can only be removed by tracking back the exact policy measures. A similar problem might occur with revenues as well. The evaluation of the nominal tax levels may not

be sufficient to derive conclusions on the actual change in the tax system (e.g. in Turkey when the corporate tax rate was cut by half to 18% in 2010 the nominal corporate tax inflow was higher than in 1998).

1.1.1 Types of Fiscal Policy

Depending on the purpose the stimulating or constraining fiscal policy is spent. During the slump in production periods, it is necessary to increase the State expenditure, to reduce taxes, or to do both that and another to stimulate a policy. In the short-term period, it softens the business cycle. In the short-term period, it softens the business cycle. In the long term, a decrease in taxes can lead to stimulation of economic growth. So was in the 1980s in the developed countries where tax reforms resulted in lower rates of the profit of corporate tax, surtax, and promoted economy lifting.

With a view of a decrease in rates of inflation it realizes constraining the fiscal policy. It consists of a reduction of the State expenditure, an increase in taxes, or a combination of those and other measures. In the short term period, the constraining policy allows us to reduce cumulative demand and by that helps decrease in inflation of demand. In the long-term period, it can lead to a slump in production and unemployment growth.

To assess the effectiveness of a government's fiscal policy, it's crucial to evaluate its outcomes. While the state budget's condition, reflected in deficits or surpluses, is often used, it is a difficult indicator. This is because budget deficits and surpluses are influenced both by deliberate changes in government spending and taxes (discretionary policy) and by fluctuations in national product and income (built-in stability).

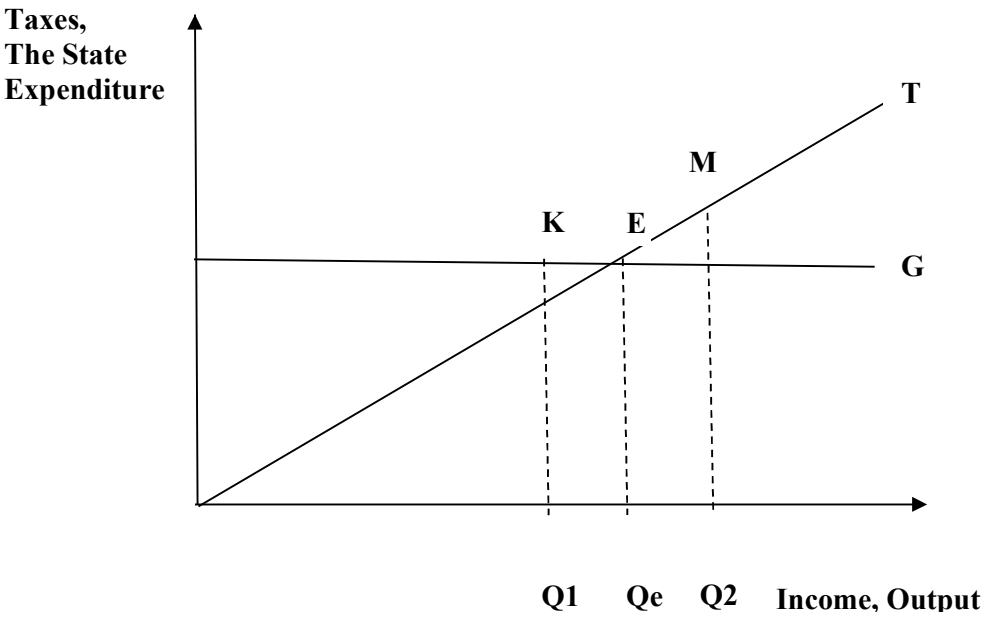
To assess the effectiveness of implemented policies, the full employment budget is used. It reveals the budget deficit or surplus that would exist under full employment conditions. Consider budget deficits and surpluses **(Figure 1.1)**. Assume the budget balances at point **E** with output **Qe**. With an actual output of **Q1** and full employment potential at **Q2**, the budget deficit **K** at **Q1** may indicate stimulative fiscal policy is occurring or increasing.

However, actually no stimulating measures are undertaken. It proves that at full employment, both the same actual State expenditure and tax lines **G** and **T** remain on former places; the full employment budget has surplus **M**. Thus, the reason for the

actual deficiency is the slump in production. The fiscal policy, on the contrary, was constraining and partly therefore the level of production in the country was below potential. There is a necessity for the acceptance of appropriate fiscal measures, i.e. for stimulation of cumulative demand.

Figure 1.1

Budgetary Deficiencies & Surpluses, the Full Employment Budget



Change in the budget of full employment shows, how the spent fiscal policy influences cumulative demand shift. Growth of deficiency or reduction of a surplus of the budget of a full employment testifies to carrying out the stimulating fiscal policy directed on the expansion of cumulative demand. On the contrary, the reduction of deficiency or increase in the surplus of the budget of a full employment grows out of the realization of the constraining fiscal policy, which proposes a reduction of cumulative demand.

However, in these cases, the amortization is written off in the sizes that significantly exceed the valid deterioration in the basic capital, in consequence, the rise of price can be made with the help of the equipment production. If accelerated amortization expands the financial opportunities of the businessmen, it simultaneously deteriorates the condition of realization of production and reduces the purchasing power of the population. Depending on the character of the use of direct and indirect financial

methods, it distinguishes two kinds of fiscal policy of the state: discretion fiscal policy or automatic fiscal policy.

1.1.2 Discretionary fiscal policy

One of the basic tools of macroeconomic regulation is fiscal policy. As a fiscal policy understand a set of the measures undertaken by governmental bodies on change of the State expenditure and taxation. Its primary goals are; smoothing fluctuations of a business cycle, maintaining steady rates of economic growth, achieving a high occupation level, and a decrease in inflation.

The fiscal policy depending on mechanisms of its regulation on change of an economic situation shares the discretionary and automatic fiscal policy (the politician of the built-in stabilizers). Discretion (Lat. *discretio* - acting at one's own discretion) the policy (politics) means the following. The state consciously regulates its expenditure and taxation with the purpose of improving the economic situation of the country. At the same time, the government takes into account the following check-up on practice functional dependencies between financial variables.

The first dependence, the growth of the state expenditure increases cumulative demand (consumption and investments). Thereby increases output and employment of the population. It is important to take into account, that state expenditure influences cumulative demand the same as investments (work as the animator of investment which was developed by J. Keynes).

Other functional dependence shows that an increase in the sums of the taxes reduces the personal available income of the household. In this case, there is reduced demand and volume of production and employment of labour. On the contrary: a decrease (reduction) in taxes increases the consumer expenditure, production, and employment. The change in taxation has multiple effects. However, the multiplier of the taxes is less than the multiplier of the investments and state expenditures. The increase in a unit of a gain of the investments (and state expenditures) is directly influenced by an increase in the volume of the GNP. A reduction of taxes increases available income, however, part of it goes into consumption, and the remaining share is spent for savings. The mentioned functional dependences are used in the discretion policy (politics) of the state for influence on the business cycle. Certainly, this policy (politics) differs in

different phases of a cycle. For example, in a crisis, the policy (politics) of economic growth will be carried out. In the interests of growth GNP the state expenditures are increased, the taxes are reduced, and the growth of the expenditures is combined with the reduction of the taxes so that the multiple effect on state expenses was more than the multiple effect of the taxes. A result is the reduction of the recession of manufacturing.

When there is an inflationary growth of manufacturing (a rise, induced by a surplus of demand), the government will carry out policy (politics) that hold back business activity - reduce state expenditures, and increase taxes. These measures are combined so that the multiple effect of reduction of the expenditures is more than the multiplier of growth of the taxes. As a result, the cumulative demand is reduced, and volume GNP accordingly decreases.

As a discretionary policy understand a conscious manipulation of the government, the State expenditure and taxes, that is still termed as an active fiscal policy. It can be carried out with the help of both direct and indirect tools: To the first - changes of the state purchases of the goods and services, transfer payments, the second – changes in the taxation (rates of taxes, tax privileges, base of the taxation), to the politician of the accelerated amortization.

We consider the mechanism of a discretionary fiscal policy, using the Keynesian model “incomes – expenses” and believing that: 1) the State expenditure doesn't influence either consumption or investments; 2) pure export is equal to zero; 3) the price level is constant; 4) originally in economy there are no taxes; 5) the fiscal policy affects cumulative expenses (cumulative demand), but not on the cumulative offer. Considering these assumptions, let us analyse the influence of the change in the State expenditure on the volume of national manufacture (release), and the income. Let's assume that originally cumulative expenses included consumer expenses with and investments **I**, and the economy was in balance at point **E1 (Figure 1.2)**.

In connection with the beginning slump in production, the government has decided to support demand, having increased cumulative expenses at the expense of the state purchases **G** (we will consider at first only this element of the State expenditure). It has carried out purchases of goods and services for the sum of 20 billion USD. This State expenditure is independent, i.e. is constant for any output. Therefore, they will

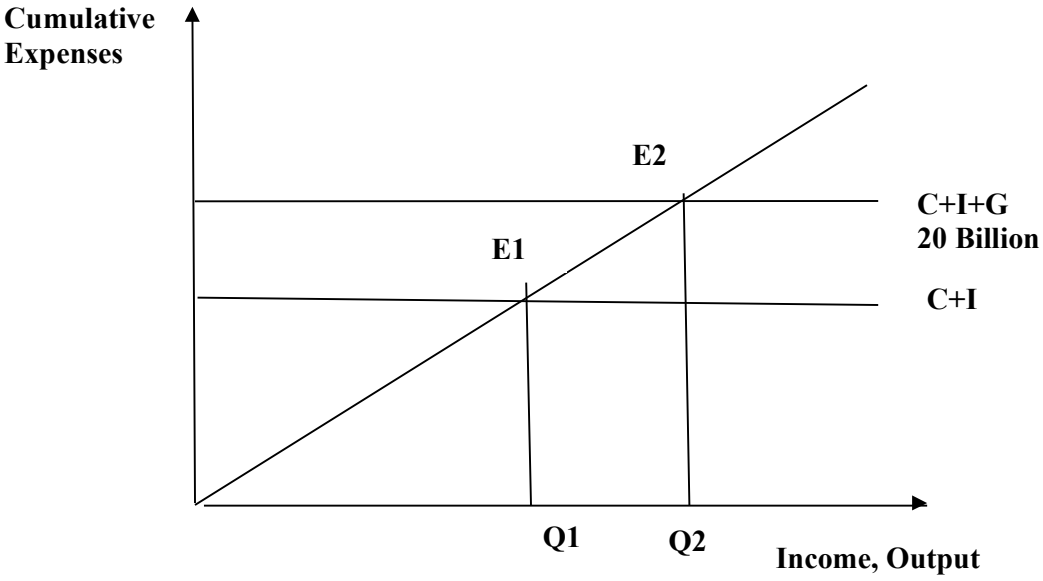
lead to an increase in cumulative expenses too on 20 billion USD that will cause a shift of straight line **C+I** upwards on size **G**, in position **C+I+G**. Planned expenses begin to exceed the equilibrium volume of release **Q1**. In the firm answer will start to expand manufacture. This process will proceed until there is equality between cumulative expenses and release volume. The new position of balance will be reached in point **E2** at release **Q2**. The increase in state purchases stimulated the growth of the volume of output from **Q1** to **Q2**. The distance on a vertical between straight lines **C+I** and **C+I+G** shows the size of the state purchases and the distance between **Q2** and **Q1** - an output gain. From the drawing, it is visible that this gains several times exceeds the volume of the state purchases, i.e. the last possess effect of the animator. The animator of State expenditure **Mg** shows the change of output, the income as a result of a change of expenses of the state. This can be calculated under the formula:

$$Mg = \frac{1}{(1\text{-}MPC)}$$

$$Mg = \frac{\text{Change of real National Product (Income)}}{\text{Change of the States Expenditure}}$$

Figure 1.2

The State Purchases and Equilibrium National Product



The animator of the State expenditure is equal to the animator of investments as they render identical effects on the economy. The growth of the state purchases (as well as

investments) creates additional demand for goods and services which causes the primary increment of the income equal to the growth of the State expenditure. The part of this income defined by limiting propensity to consumption will be used on consumption that will lead to the further increase of cumulative demand and the national income etc. Hence, change of the State expenditure actuates the same process of animation of the national income, as well as change of private investments. Therefore, the animator of the State expenditure is possible to define with a formula.

To define the change of a real national product (income) received as a result of the growth of the state purchases, it is necessary to increase animator **Mg** by a gain of the State expenditure **dG.** During the periods of the lifting of the economy when private expenses are great enough, the government reduces purchases of goods and services. Reduction of the State expenditure is accompanied by a shift of a curve of cumulative expenses **C+I+G** downwards and leads to animated reduction of volume of a national product, incomes.

The same as changes in the state purchases, volume of release, incomes, operate changes of transfer payments which are an element of the State expenditure. However, the efficiency of their influence on demand, and on the volume of a national product is slightly less. This results from the fact that transfer payments to the population lead to the growth of its income, but only their part is defined by limiting propensity to consumption **MPC**, the population uses on consumption, increasing by the same size cumulative expenses. The mechanism of influence of the change of transfer payments on release, incomes is similar to what operates at the change of taxes.

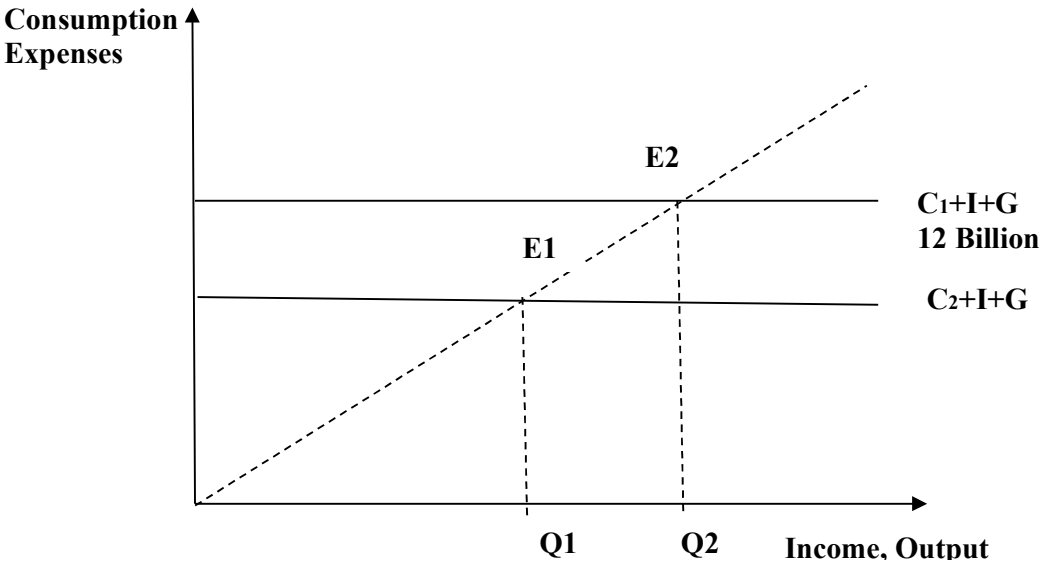
The State expenditure had stimulating action; they shouldn't be financed at the expense of tax revenues. Growth of tax rates will lower stimulus to business activity which will lead to a reduction of the volume of output and income. Therefore, growth of the State expenditure, as a rule, is accompanied by budgetary deficiency. Thus, by increasing expenses in a slump in production and reducing them during economic lifting, the State softens economic crises and achieves smoother growth of volume of national manufacture.

The tools of discretionary fiscal policy are changes in taxation. We will consider how the introduction of the accord (lump-sum) tax will affect the volume of a national product. It is the tax in a strictly set sum whose size remains constant at the change of

volume of release. We will admit that at cumulative expenses **C1 + I + G** the equilibrium condition was reached in point **E1** at volume of release **Q1**. **(Figure 1.3)**

Figure 1.3:

Accord Taxes and Equilibrium National Product



Formula:

$$Mn = \frac{1}{(1\text{-}MPC)} = \frac{1}{(1\text{-}t)\ MPC}$$

The state imposes the accord tax from the population equal to 16 billion USD. The population uses the incomes on consumption and the savings, the parity between which changes are defined by limiting propensity to consumption **MPC**. Taking into account **MPC** tax introduction of 16 billion USD will cause a reduction of consumption by 12 billion USD which will lead to a reduction of cumulative expenses of the same size. Straight line **C1 + I + G** will move downwards in position **C2 + I + G**. Reduction of expenses and demand will be accompanied by curtailment of production until there will come a new equilibrium state in point **E2** at volume of release **Q2.** Apparently from the drawing, the distance between **Q2** and **Q1** is more than the difference on a vertical between straight lines **C1+I+G** and **C2+I+G**, i.e. is more than 12 billion USD

that testifies to the presence of the animator of taxes. This results from the fact that a change in the state purchases on one monetary unit leads to the same change of cumulative expenses and a change of the accord tax to the monetary unit and is accompanied by a change of cumulative expenses on **MPC x 1**. Therefore, the tax animator will be equal:

Formula:

$$\mathbf{Mn = MPC.\ Mg \text{ or } Mn = \frac{MPC}{(1\text{-}MPC)}}$$

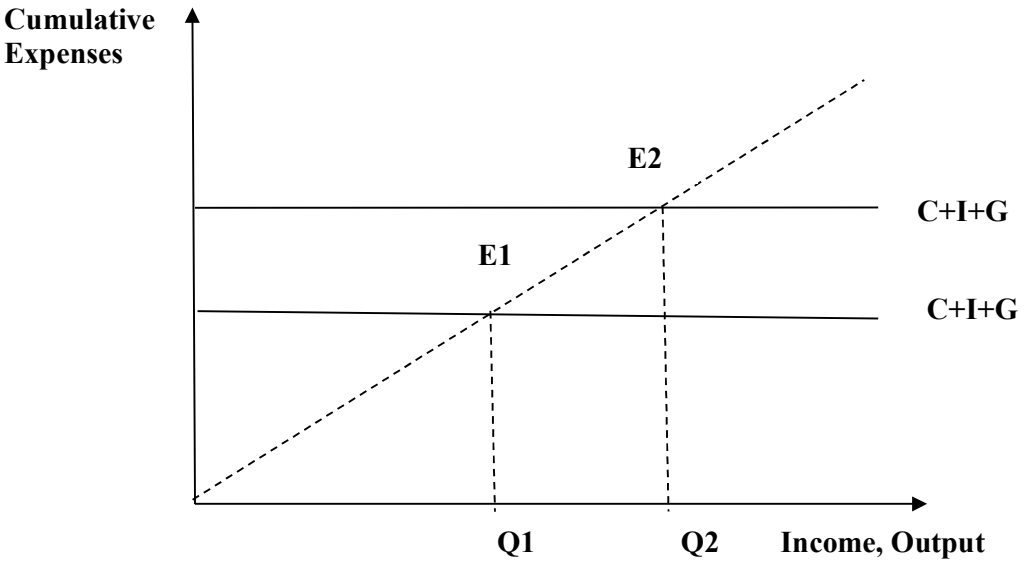
Under the same formula, it is possible to calculate the animator of transfer payments. However, if the increase in taxes leads to a reduction of a national product, income growth of transfer payments, on the contrary, promotes their increase.

In practice accord taxes meet seldom enough. As a rule, with an increase in the volume of release, income taxes grow. We will consider how a change in rates of the proportional tax influences cumulative expenses and national product. Let us admit that at the tax rate equal to zero, the economic system will be in balance - point **E1**. Equilibrium volume of release **Q1**.

We assume that the state is imposed by the income proportional tax, which rate **t**. If the income of the population before tax introduction was **Y**, after tax collection the income can be calculated as: $\mathbf{Y - tY = (1 - t)\ Y}$ (independent taxes will not be considered in calculations). It means that each monetary unit of income earlier on consumption left **MPC x 1**, and now: **(1-t) MPC**, i.e. new limiting propensity to consumption **MPC** will lead to a decrease in an inclination of a curve of cumulative expenses, i.e. to its shift in position **C + I + G**. The balance point will move from **E1** in **E2** that will lead to reduction of volume of national manufacture with **Q1** to **Q2**. Taking into account the new value of limiting propensity to consumption **MPC** the tax animator it is possible to calculate under the formula:

Figure 1.4:

Proportional Taxes and Equilibrium National Product



To define, the equilibrium output (income) was reduced to what size at the introduction of the tax rate **t**, it is necessary to increase the initial reduction of consumer expenses received as a result of the introduction of a surtax on the animator. If before the introduction of the tax level of the national income was **Y1 = Q1** after its withdrawal the income has decreased to **tY1**, and consumer expenses on **MPCtY1**.

Formula:

$$dY = -Mn\text{-}MPCtY1 = \frac{-1}{(1-t).\ MPC}$$

1.2 LITERATURE REVIEW

1.2.1 Experiences of Fiscal Crisis and Reform measures:

As different studies on experiences of fiscal crisis and reforms provide a good insight into the reasons of the crisis and required reform measures, a detailed review of various works on fiscal crisis and resultant fiscal reforms measures have been carried out in this section.

World Bank, (2005) had compiled a number of studies on international experiences with fiscal reforms. The review of those studies provides guidelines about types of fiscal reform required to bring fiscal stability in a state. These include studies by Alesina and Perotti, (1995); Alesina and Ardagna, (1998) etc. According to them, fiscal-reform strategies used to bring fiscal stability could be broadly divided into two categories; Type-I primarily relies on cuts in recurring spending and Type-II primarily relies on tax increase with spending cuts mostly limited to public investments. They found that Type I reform measures were more effective in fiscal adjustment compared to the type II. Following Alesina and Perotti, (1995), in a study of 20 OECD countries for the period of 1960-94, 60 episodes of fiscal consolidation were identified. Of these episodes, only 16 were lasting, and among these successful cases, 73 per cent were based at least in part on current spending cuts. They came out with the conclusion that although most fiscal adjustment efforts relied on tax increases to lower the deficit and debt burden, those successful in addressing fiscal imbalances relied heavily on cuts in current expenditure than increase in taxes.

Gupta, (2003) opined that the reallocation of public expenditure towards more productive uses was important for achieving more sustained fiscal adjustment. The author was in favour of fiscal consolidation through cuts in selected current expenditure, while protecting or increasing capital expenditure. His study also found that poor governance and high unemployment were some of the obstacles to achieve sustained fiscal adjustment.

As different states of India have many similar features, the studies of other states are crucial for a state like Nagaland for formulating its fiscal strategies. In Indian context,

Rao, (2002) had made a critical analysis of the state level fiscal crisis that took place in India in the later part of the nineteenth century. According to him, there was sharp deterioration in state finances which was mainly due to spillover of Central policy on pay revision of state governments and low buoyancy of central transfers. There has been a steady deterioration of the states' own tax revenue, significant drain on state resources due to losses from public enterprises and proliferation of explicit and implicit subsidies. The author, however, found variation in the severity of fiscal deterioration among the states. The deterioration was found to be the most severe for West Bengal with both revenue and fiscal deficit as percentages of NSDP had worsened by about five points between the periods 1995-96 to 1999-2000. For the same period, the deterioration in revenue deficit was very high for Punjab, (4.4%), Rajasthan (4.2%) and Maharashtra (3.7%). Marked deterioration in fiscal deficit was also noticed in case of Bihar (5.3%), Punjab (3.9%), Orissa (3.4%) and Maharashtra (3.1%).

1.2.2 Expenditure Implications of the Fiscal Crisis and Reform Measures

Fiscal crisis or imbalance of a government compels the respective governments to adopt different fiscal reform measures which may have serious implications in term of reduction and shifting of expenditure from priority sectors. At the same time, it is equally true that any successful reform measures require some kind of adjustment of the government expenditure. This section of review of literature will be carried out to know the expenditure implication of fiscal reform measures as well as role of efficient expenditure management towards successful fiscal reform campaigns.

Glingham et al., (2008) based on their study on Honduras found that public expenditure programme such as energy subsidies, university education and public pension programme provided disproportionate benefits to the higher income households. They were of the view that progressivity of public policy could be increased by reducing those expenditure that were poorly targeted.

Endersby and Towle, (1997) viewed that different governments had employed various statutory and constitutional devices to limit government spending. Many of these devices are intended to increase executive control over expenditures. The authors found that such efforts were ineffective or counterproductive. They were of the view

that state legislatures controlled by a single party were more likely than divided legislature to limit government spending and minimise debt. Thus, political and electoral influences appear to explain the state expenditure better than legal restrictions on the appropriation process.

Mathur, (2001) viewed that public expenditure management has an important role in containment of fiscal deficit as effective and efficient public expenditure management helps to contain fiscal deficit. Therefore, public expenditure management should be the main instrument of states' fiscal policy in India.

1.2.3 Revenue Efforts of the Government

Any fiscal reform measures accomplished through reduction of expenditure may have serious social and economic cost. Available theoretical literature such as Wagner, (1833); Peacock and Wiseman, (1961); Gupta, (1967); Goffman, (1968); Pryor, (1969); Musgrave, (1969) argued that emphasis should be given on economic growth which leads to increase in public expenditure. The best option available to a government is to increase the revenue effort so that economic growth leads to more generation of revenues. Sufficient revenue generation enables a government to provide uninterrupted flow of funds for different expenditure responsibilities. This section of the review of literature will be carried out to analyse revenue efforts of different tiers of government to explore the possible ways to increase revenue of a government. This section also highlights the theoretical issues related to revenue effort of a government.

Rose, (1985) emphasised on increase in tax revenue through proper tax effort which according to him was a function of law and administration as well as economic activity. He was very critical about the non-decision-making approach by the politicians towards tax policy. He found that the strategy to rely primarily upon revenue-buoyant taxes authorised by past legislation rather than risk the political blame for introducing new taxes restricts the generation of additional revenue.

Davoodi and Grigorian, (2007) viewed that mere high economic growth might not lead to more collection of revenue. They gave the example of Armenia where the despite of double-digit growth since the year 2000, the country's tax-GDP ratio had been fairly

stable at about $14^1/_2$ per cent. They identified that persistence of Armenia's low tax GDP ratio could be traced to persistence of weak institutions and a large shadow economy. The gap between the potential actual tax collections in Armenia was as high as $6^1/2$ per cent of GDP. They advocated for increase of the tax-GDP ratio of the country by broadening the base, removing exemptions and improving its VAT refund mechanism to boost tax morale and reduce the willingness to stay in the informal shadow economy.

Panda, (2009) gave importance on tax effort on the part of the sub-national governments in India to increase their own revenue and reduce the dependence on central transfers. He applied the panel data model to examine the revenue effort of the government and found that tax efforts of many state governments were not sufficient compared to their revenue potential. There was always a gap between the revenue potential and actual collection of revenue of a state. The author was of the view that higher central transfers have a disincentive effect on the tax efforts of the state governments in India. There is a need on the part of the Finance Commission of India to put more weightage on revenue effort while distributing funds to the state.

1.2.4 Fiscal and Debt Sustainability of the State:

As different countries around the world have been experiencing fiscal deterioration, the issue of fiscal and debt sustainability has emerged as an issue of discussion in recent decades. The persistence increases in the deficit indicators of both the central and state governments in recent nearly three decades increases the relevance of the issue in India. The present section is an attempt to make a review of existing literature on fiscal and debt sustainability.

As part of the research requirement, an attempt is made to make a review of studies relating to fiscal reforms including VAT implementation and their impact on the national and sub national levels. An appreciation of such contributions and ideas will help us in highlighting the issues involved and evolving our approach to reading the importance of reform though our efforts may not include all the exhaustive review in the area under study. The review of various studies provides us with broad ideas relating to different aspects of shortcomings causing fiscal failures in various fronts

and the impact of the measures undertaken to counter them. In addition to that, it picturizes the degree and extent of successes or failures in achieving the desired objectives after implementing the corrective measures prescribed. Political economy of development succumbs to the global order of restructuring in time. Misallocation of resources ends up with precarious debt and deficit fiscal health when it lags output. The part of this section also reviews the findings and contributions of different studies on fiscal crisis in the international, national and sub national levels.

Flavin and Hamilton, (1986) viewed that in order to issue interest-bearing debt, a government must promise to balance its budget in present value terms. Debt sustainability, according to them, was the main instrument for the overall sustainability of a government.

Gupta, (2003) found that implementing durable fiscal reform and controlling public debt had been a major challenge for policy makers around the globe particularly for emerging market economies during the 1990s. His study highlighted the potential fiscal risk of increasing public debt as it had risen since the mid-nineties of the previous century and stood above 70 per cent of the GDP for those countries. The increase was found to be more noteworthy in Asia and Latin American countries.

Rajaraman and Mukhopadhyay, (2005) in their paper had examined the time series properties of debt-GDP ratio of India in undiscounted terms using structural time series model. Their study which covered the period 1952-97 found that there was an immediate need for fiscal correction in India to preserve public solvency.

The Bretton Woods Era of fixed exchange rate failed to accommodate the economic change in the 1970s and 1980s. It imposed inflexibility into the fiscal and monetary measures to restore the domestic economy. Carrasco (2008) brings out the contribution of IMF in resolving the crisis in its acute phase. Dymsky (2003) analyses the reasons of international debt crisis since 1980s and provides a broad range of suggestions to meet the challenge comprising fixation of macroeconomic policies and rules governing cross border financial flows in the global economy. Naim (1999) in a similar study discusses the economic impacts in countries who adopted the policies of the

Washington Consensus. Sustainability of the policy came under questioning as it could not embody the changes in the international economic, political environment as well as domestic realities. In a study relating to global financial markets, Piccitto, Sol and Haines (1999) trace the origin of internationalization of financial markets to emergence of new competitive pressures, rooted in changes in the social structure of savings and investment, breaking down both national system of financial control and international arrangements of monetary and financial coordination. Stiglitz (2000) in his study enlightens us about the spread of world economic crisis in different countries and the role of the International Monetary Fund in crisis management. Macedo (2000) in a similar study highlighted the various prospects of global financial architecture and gave emphasis on improved surveillance as security measure.

Williamson (2002) traces out the reasons for disappointing outcomes of countries adopting the Washington Consensus and in an earlier study (1999), the author concluded that it failed to bring about any hope to ensure the basic requirements of nutrition, education and health, housing and entertainment to the adopting countries while establishing the supremacy of market-oriented economy.

Easterly (2001) speculated that the attributable reasons could be for increase in world interest rates, increased debt burden and the slowdown in the industrial world in developing countries.

Maxwell (2005) emphasizes that the role of Millennium Development Goals (MDGs) can be improved by paying more attention to rights, equity and social justice to the problems of 'infant economies' and to issues of aid policy and architecture. While reviewing the economic performance of Asia, Burton and Zanello (2007) concluded that a decade after 1997-1998, the crisis period, things improved in the global economy and they have given their suggestions for further improvements to meet new challenges in the region. Another study made by Malliaris (2006) emphasizes that Bretton Woods system had proved to be remarkable, durable, adaptable and successful. The role of IMF in building global economy through surveillance, lending and technical assistance has beyond doubt proved successful in restoring global economic order. In the study, the fundamental economic developments in major economic areas are discussed along with suggestions for changes in the practices and procedures of IMF to explain the relative financial stability of global economy.

The study concludes that rapid economic growth in a low inflation environment for majority of economic regions contributed to an improvement of financial stability of the global monetary system. Chadha, Pohit, Deardoref and Stern (1997) while making an analysis of India's policy reforms have found that import liberalization enhances the welfare in the economy and that the effect gets further enlarged if exports are also liberalized simultaneously. Ahluwalia (1999) evaluated the fiscal achievements by gradualism in a seven-year period and emphasized that poor state of social indicators in India is obviously not a consequence of the reforms but a reflection of prolonged neglect of these crucial reforms in the pre-reforms era.

In the post reform period, there has been an increase in interstate disparity although significant decline in poverty has been observed in all states except Orissa. In another study, Ahluwalia (2000) attempted to explore the reasons for such growth inequality and tried to identify crucial issues that need to be addressed by the slow growing states. Chelliah (1999) points out that the major reforms carried out in the years 1991-92 to 1994-95 had very favourable effects in improving the Indian economy assessed in terms of growth in GDP, tremendous increase in foreign investment, a very large flow of remittances with a realistic exchange rate, remarkable growth in exports and no balance of payment problems after 1991-92.

India's development strategy including economic reforms and macroeconomic performance in international perspective was reviewed by Klein and Palanivel (2000). They found that improvement in economy was largely due to financial and trading integration of India with the global economy. Shand and Bhide (2000) examined growth aspect in Indian Economy. By observing data of 14 major states as sample, they concluded that there has been a strong positive correlation between GSDP[2] growth rates and investment levels in the reform period 1990's in the government and private sector. There is a strong inverse association between fiscal deficit and debt levels to GSDP growth rates. The importance of economic and social infrastructure was also examined. The service sector growth has been the prime driving force during the reform period. In course of a review of economic performances after a decade of reforms, Rao (2000) brought out the trends in fiscal imbalances of states combined from 1980-81 to 2000-2001 and of individual states from 1990-91 to 1999-2000. The study concludes that there has hardly been any reduction in the share of capital

expenditure after a decade of reforms. They pointed out that to launch the Indian economy to a higher growth trajectory will depend crucially on state level fiscal reforms.

The new dynamism that India could achieve in the process of reforms is well recognized in a study by Bajpai and Sachs (2000). on the basis of their study, they suggested ten crucial initiatives including universal literacy, aggressive public health campaign, enhanced family planning policies, completion of economic reform agenda, political decentralization, enhanced global role in India, commitment to IT backbone, strengthening of economic, cultural, investment, scientific ties to overseas communities, strengthening science and technology in India's development policies and major commitments to Indian higher education. They also looked into the centre-state fiscal relations and their implications for structural deficits. Japan Bank of International Cooperation (JBIC) (2001) assessed the expenditure management in India with an objective to identify major tasks ahead. The study provides an overview of reforms and trends in the fiscal sector of the Indian Economy. It contains the essentials of good governance and effective public expenditure management. Pangariya (2001) while assessing reform outcomes emphasizes growth acceleration. Khatri and Kochhar (2002) who made a study of the Indian Economic Scenario for a period 1988-89 to 2001-02, made a comparison with some successful fiscal adjustment countries like Australia (1987), Belgium (1984-85), Denmark (1983-86), Ireland (1987-89), Italy (1993) and the four east Asian countries like Indonesia, Korea, Malaysia and Thailand and could draw the conclusion that the success in India could be gained through widening base of trade taxation, simplification of corporate and personal income taxation, rationalization of exemptions and reduction, lowering of rates in income taxation and introduction of broad based consumption tax. Singh and Srinivasan (2002) while examining several dimensions of economic reforms in India in the context of country's federal system and of globalization recognized that the centre and state, the two layers of governments interact with foreign governments and corporations in a global economy. To obviate regional disparity, intergovernmental transfer system need to be made more effective and efficient. While dealing with macroeconomic stability aspects of sub national finances and their contribution to overall fiscal imbalances of the country, Rao (2002) analysed the extent to which

intergovernmental fiscal policies and institutions have helped or hindered growth efficiency during the last decade. In the opinion of the author, federalism has advantage over the unitary system as the former provides a large common market while providing a wider choice of fiscal packages as well as intergovernmental competition.

Sachs, Bajpai and Ramiah (2002) find growth disparity in the Indian states after economic reforms. In a study of social impact of reform process, Dutta (2002) finds out that liberalization and privatization along with globalization process in India have led to erosion of living standard of the poor, increase in regional disparities in terms of industrial benefits, sluggishness in employment generation, greater casualization, feminization and deskilling of the workforce, growing uncertainty and hidden hardships.

Kaur and Kaur (2015) aims to assess the fiscal performance of Punjab state by examining the major fiscal policy indicator in the pre and post reform period and investigating the performance of state on the fiscal front after the implementation of FRBM act. The present empirical investigation is based on the secondary data compiled in the form of regular time series of 34 years from (1980-81 to 2013-14) for the state of Punjab. The data on various policy indicators the ratios and trends are analysed and concludes that the government has been using the borrowings for debt servicing and leaving only 10 percent for development purposes. This problem has created a vicious cycle. Revenue deficit is found to be the major factor affecting the fiscal situation of Punjab. As far as the quality and impact of FRBM is concerned, it has not fully realized its targets yet.

Tax Reforms in EU Member States (2015) is discussed in which reviews the most important tax reforms recently implemented in EU Member States and discusses a number of challenges relating to tax policy that may affect macroeconomic performance, in terms of growth, employment, public finances and macroeconomic stability. The report provides a basis for dialogue on the role of tax policies in promoting sustainable growth, employment and social equity. In this context, it also encourages a valuable exchange of best practice in the area of tax reforms, and the report contributes to an informed dialogue with civil society on what is generally considered a sensitive topic. This is particularly relevant and important in the current

economic context. Although the levels of inequality, as measured by market income (income derived from work and capital), rose significantly in the EU during the crisis years 2007- 2013, income inequality after taxes and benefits changed relatively little. At least until 2013, tax and benefit systems were able to contain a significant part of the increase in market inequality in most Member States. There is, however, significant variation between countries, and the level of inequality increased in some Member States even taking into account the effect of taxes and benefits. Furthermore, low-income households in some Member States have seen their living standards deteriorate disproportionately.

The IMF policy paper (2015) explores how fiscal policy can affect medium- to long-term growth. It identifies the main channels through which fiscal policy can influence growth and distills practical lessons for policymakers. The particular mix of policy measures, however, will depend on country specific conditions, capacities, and preferences. The paper draws on the Fund's extensive technical assistance on fiscal reforms as well as several analytical studies, including a novel approach for country studies, a statistical analysis of growth accelerations following fiscal reforms, and simulations of an endogenous growth model. Fiscal policy is an effective tool for supporting growth. While it is difficult to disentangle the impact of fiscal reforms from other factors and to determine causality with certainty, the analysis suggests that they could lift medium- to long-term growth by ¾ of a percentage point in advanced economies and even more in developing economies. Fiscal policy promotes growth through macro and structural tax and expenditure policies. At the macro level, it plays an important role in ensuring macroeconomic stability, which is a prerequisite for achieving and maintaining economic growth. At the micro level, through well-designed tax and spending policies, it can boost employment, investment, and productivity.

Kaur (2014) discusses the impact of fiscal reforms on fiscal performance of the central Government and compares revenue and expenditure position of the central government in pre-reform and post-reform period. The fiscal performance of the central government for the period of 1975-76 to 2007-08 has been analysed. With the initiation of fiscal reforms process, the immediate impact was the sharp reduction but thereafter there was a steady reduction, and the reduction was sharper after the

enactment of the Fiscal Responsibility and Budget Management Act (FRBMA), 2003 in both the revenue and fiscal deficits of the central government. This improvement in the fiscal position of the central government has been achieved on the strength of higher revenues. Due to lesser efforts being made to compress expenditure during the first decade of economic reforms process, expenditure continuously increased and grew by sixty-four times during the study period. What is more disturbing is that revenue expenditure shot up only at the cost of capital expenditure. It constituted more than 60 per cent and even reached to cent per cent of the total expenditure of the central government. While capital expenditure of the central government constitutes merely 4 to 37 per cent of the total expenditure during pre as well as post-reform period. So, there is an urgent need to restrain the growth in revenue expenditure.

Chakraborty and Bharatee (2013) have examined whether the introduction of fiscal rules has helped in bringing fiscal discipline at the sub national level in India and how the fiscal rule has impacted on development spending at the sub national level. Using the data from Handbook of Statistics on Indian Economy 2010-11, RBI, State Finances: A Study of Budgets (various. issues), RBI and using panel-correcting standard errors (PCSE) and feasible generalized least squares (FGLS) estimation methods it has been found that it needs to be emphasized that fiscal reforms have largely been revenue driven growth. Although there has been an improvement in the aggregate fiscal position of the states till 2007-08, there has been disparities in fiscal performance across states. Increasing disparities in per-capita spending has increased in recent years. The econometric exercise reveals that the state level fiscal policy and fiscal rule has been successful in reducing fiscal imbalance even when we control for other policy shocks and other standard determinants of fiscal balance. However, it is clear that fiscal targets under fiscal rule have been achieved through a cut in discretionary development spending. It also shows that cut in spending has been partially offset by higher central transfers.

1.3 THE INDIAN FISCAL SYSTEM

At the time of independence in 1947, India inherited an economically stagnant economy. The framers of the Indian Constitution tried to build a strong united India, both to ensure the cohesiveness of a vast country and to build a sound fiscal system of government. So, India adopted federal structure with the union of a central and the state governments to actualize and uphold the values of national unity, cultural diversity, regional autonomy and rapid socio-economic transformation. Indian fiscal system with a constitutional division of the revenue powers, expenditure functions and the powers of borrowing between the centre and state governments is not free from the problems. Though the tax powers are distributed clearly among centre and state governments under Article 246 and Seventh Schedule of the Indian Constitution, but the division of tax powers based on efficiency considerations and scientific principles creates the problem of gap in the revenue resources and requirements of the states. Since 1980s, economists (like Bhargava, 1984; Mohan, 2003; Singh, 2004) have observed that the states have been assigned limited tax powers as compared to the central government. In the case of distribution of expenditure powers, the main functions of the central government are those which are necessary to maintain macro-economic stability, international trade and relations. The major sectors assigned to the states comprise public health, agriculture, irrigation, education, industries and minerals, which require huge funds. So far as another important instrument of fiscal system, i.e., the borrowing powers of the centre and state governments are concerned, it is regulated by Articles 292 and 293 of the Constitution. While there are no restrictions on the central government, but limited borrowing powers of the states is said to be a knotty problem' of the fiscal system. The Constitution recognizes that its assignment of tax powers and expenditure functions would create imbalances between expenditure 'needs' and abilities to raise revenue of the state government. To correct this imbalance, the Constitution provided statutory fiscal transfers from the centre to the states through the instrument of the Finance Commission. The main function of the Finance Commission is to recommend allocations of central taxes, grants and loans to the states. In addition, the Planning Commission also gives assistance to the states on the basis of an established formula (Gadgil formula).

Under such a fiscal system, the fiscal performance of both the centre and state governments remained comfortable till 1980. But there was a significant deterioration in the fiscal situation in 1980's, especially by the second half, which was marked by high and persistent fiscal deficits. This large fiscal deficit had some spill-over effects on the external sector which was reflected in the widening current account deficit in the early 1990s. The need to start the fiscal reform process as a part of economic reforms in 1990-91 was realised. As such a comprehensive fiscal reform programme at the central government level was initiated in 1990-91. The primary objective of the fiscal reforms programme was to achieve a reduction in the size of deficit and debt in relation to GDP. A major reform in the Indian federal structure was made in 1992, when a two-tier structure was transformed into three tier structure. In the 73rd and 74th constitutional amendments, rural and urban local bodies, which till then functioned as agencies of the state governments, got statutory recognition to provide an enabling environment for decentralized provision of public services. No doubt, Indian fiscal reform programme is based on the policy of gradualism and evolutionary transition rather than rapid restructuring 'shock therapy' (Mathur, 2001) but now a period of two decades is over, so it seems important to analyse and assess the usefulness of the reforms. Such an analysis will provide insights to redesign the fiscal reform process relating to revenue mobilization, expenditure restructuring and debt reforms in future. India has experienced rapid economic growth over the past two decades, averaging about 6% per year. Sustaining and accelerating this progress, as per the country's development targets, will require an improvement in government effectiveness, not only at the central but also at the state level, given the extensive responsibilities of India's state governments for infrastructure and human development. But fiscal deterioration, especially acute in the late nineties, has weakened the development effectiveness of state governments in India by squeezing productive spending and reducing its quality, especially in the poorer states. As is well known, the fiscal situation of Centre & States deteriorated continuously in 1990s, especially after 1997. The state governments of India have embarked on two pronged fiscal reforms i.e. (i) reducing deficits and (ii) better spending on priority areas, during last one decade. Before that, fiscal management was an alien term.

The role of state governments is much diversified. The Indian constitution entrusted the states with functions both expensive and expansive such as agriculture, irrigation, roads and buildings, rural development, education, medical and public health and law and order along with revenue powers mostly inelastic in nature. Since the advent of five-year plans these expenditure commitments have been increasing considerably. Public expenditure plays a very important role in economic development. Public expenditure is the expenditure incurred by the public authorities, that is Central government, state governments and local bodies for the satisfaction of collective needs of the citizens for the promotion of economic and social welfare. The share of developmental expenditure of state governments is increasing at a faster pace than the Central government expenditure. This amply demonstrates the crucial role played by the state's expenditure in the Indian Union. The growth of expenditure of the states was to fulfil the two objectives of economic growth and economic welfare. To attain these two objectives not only public investment but also private investment is also needed. Given the current tempo while a number of states will fulfil the target, others in all likelihood may fail to fulfil the target. So also, the strategy of states appears to be ill-conceived. The revenue effort of the states cannot be said to be very impressive (Vadra Ratna, 2015).

The Special Category states receive special financial assistance and other benefits from the central government due to their unique developmental needs and challenges. The SCS is determined based on five factors: hilly terrain, low population density or sizeable tribal population, strategic location along borders, economic and infrastructure backwardness, and non-viable state finances. These determinants are based on the Gadgil formula of fiscal transfers. Currently, 11 states enjoy SCS status: Jammu and Kashmir (now a Union Territory), Assam, Nagaland, Himachal Pradesh, Manipur, Meghalaya, Sikkim, Tripura, Arunachal Pradesh, Mizoram, and Uttarakhand (Chakraborty, 2004). Nagaland was accorded special category status in 1969 along with Assam and Jammu & Kashmir.

1.3.1 Revenue Reforms

In order to augment public revenue as a measure to tackle fiscal crisis, the main focus has remained on taxation reforms and non-tax revenue front was totally neglected till the mid of 1990s.

(A) Pre-Reform Period: Since independence a number of attempts have been made at improving the tax structure in the sphere of direct as well as indirect taxes. The central government of India embarked upon the reforms process during pre-reform period mainly on the basis of recommendations made in Taxation Enquiry Report (1953-54), Report of Direct Taxes Enquiry Committee (1971), and Report of Indirect Taxes Enquiry Committee (1977). Many remedial measures were taken for various aspects of direct taxes from time to time. In the case of personal income tax, the attempt to achieve the desired state of redistribution caused the policy makers to design the income tax system with confiscatory marginal rates. This led the Direct Taxes Enquiry Committee in 1971 to recommend significant reduction in marginal tax rates. On the recommendation of the Direct Taxes Enquiry Committee, the highest marginal tax rate was brought down from 97.7 per cent in 1973-74 to 66 per cent in 1976-77 and to 50 per cent in 1985-86 to raise revenue. In the case of corporation taxes, the rate of surcharge on corporation tax increased from 5 per cent in 1975-76 to 7.5 per cent in 1979-80. It was further reduced to 2.5 per cent in 1981-82 with a view to improving financing from their own internal resources. In 1983-84, the rate of surcharge increased to 5 per cent. In line with the Long Term Fiscal Policy (LTFP), the surcharge on corporate tax was discontinued in 1985-86. As regards the wealth tax rate, the highest wealth tax rate was reduced from 8 per cent in 1974-75 to 5 per cent in 1979-80 and further to 2.5 per cent in 1985-86 and made applicable to net wealth over Rs. 20 lakh (Economic Survey, 1975-76 and 1985-86). However, on the indirect taxes side, a major simplification exercise was attempted by the Indirect Taxes Enquiry Committee (Government of India, 1977) in 1972. As the excise system had no built-in-checks against evasion, it recommended the introduction of input tax credit to convert the tax into a manufacturing stage value added tax (MANVAT), but it was not implemented until 1986-87. Then to minimize the incidence of taxation on inputs Modified Value Added Tax System (MODVAT) was introduced in 1987. As a result, ailment of MODVAT credit for payment of duty had gone up appreciably over the years. The

tariff rates were extremely high by the middle of 1980s. In line with the LTFP, the tariffs were raised to augment revenue and the weighted average rate increased from 38 per cent in 1980-81 to 87 per cent in 1989-90 (Rao, 2005).

(B) Post-Reform Period: The main focus of the fiscal reforms process during 1990s was again on the taxation front only. A process of simplification and rationalization of both direct and indirect taxes was started on the basis of recommendations of the Chelliah Tax Reforms Committee (1991) and Report of the Task Force on Direct and Indirect Taxes (2002a and 2002b). Since then, many remedial steps have been taken to simplify various aspects of direct taxes. As regards the personal income tax, many changes have been made since 1991. The maximum marginal rate was reduced from 56 per cent in 1990-91 to 30 per cent in 1997-98 to augment revenue. "A new scheme called "one by six" was introduced to widen the tax net during 1998-99. This scheme was introduced in 12 districts in 1997-98 and was extended to 133 districts in 2000-01." (Gupta and Kaur, 2004). From 2003-04, it was applicable throughout the country. This scheme was abolished in 2005-06. Significant reforms were also carried out in the area of corporate tax which aimed at increasing the generation of internal resources. By the year 1991-92, widely held and closely held (foreign and domestic) companies were taxed at 40 and 50 per cent, respectively. Following the recommendations of Tax Reforms Committee (TRC), 1991, the tax rates of closely and widely held companies were unified at 40 per cent in 1993-94 (Rao, 2005). However, the rates in 1997-98 were 35 per cent and 48 per cent in case of domestic and foreign companies, respectively. In 2002-03, the rate of tax for foreign companies was further reduced to 40 per cent while the rate of tax for domestic companies remained at 35 per cent. The corporate income tax for domestic companies was reduced to 30 per cent in 2005-06. Further, there has been no change in existing rates of corporate tax.

In the case of wealth tax, on the recommendations of the Chelliah Committee, it was charged at the flat rate of 1 per cent since 1992-93 with a basic exemption of value of Rs. 15 lakhs on taxable items of wealth. However, major relief was provided in 2004-05 in the form of abolition of tax on long-term capital gains and reduction in tax on short-term capital gains. In 2005-06, a new tax i.e., fringe benefit tax was introduced, but was abolished after realization of its considerable compliance burden in 2009-10. Measures have also been taken in the area of indirect taxes to improve the efficiency

of these taxes. The reform impetus on Excise duties came with the implementation of the recommendations of the Tax Reforms Committee, 1991. In 1999-00, almost eleven major advalorem duty rates were merged into three. In order to bring further simplification in the rate structure, the three rates were further merged into a single rate of 16 per cent in 200001 to be called a central Value Added Tax (CENVAT), along with three special additional excises of 8, 16, and 24 per cent for a few commodities. In 2008-09, the general CENVAT rate on all goods and services was reduced to 14 per cent. Import duties were more than 300 per cent prior to the reform process undertaken. A phased reduction in the peak rate of custom duty has been undertaken since 1991 and accordingly the peak rate of custom duty was reduced to 110 per cent in 1992-93 to 40 per cent in 1997-98 and to 30 per cent in 2002-03. It was further reduced to the level of 15 per cent in 2005-06 and to 10 per cent in 2007-08 with a few exceptions (Economic Survey, 2007-08). It was realised only in mid-1990s that the structural transformation took place in favour of service sector but services out of tax-net coverage was an important reason of declining tax revenue. So, in order to broaden the base for domestic indirect taxes, a modest beginning was made in 1994-95 with the introduction of selective tax on services. This tax was charged at the rate of 5 per cent on the amount of telephone bills, the net premium charged by insurance companies and the brokerage charged by stockbrokers in relation to their services. In 2002-03, the coverage of service tax was extended to 60 services at the rate of 5 per cent. The rate of service tax was raised to 10 per cent and number of services was raised to 84 in 2005-06. In 2007-08, the coverage of service tax was extended to 100 services at the rate of 12 per cent (Economic Survey, 2008-09). A comprehensive indirect tax reform in the country is going to take place in April 2011 with the implementation of a dual Goods and Service Tax (GST), levied concurrently by the centre as Central Level GST (CGST) and the states as State Level GST (SGST). GST would be further improvement over VAT. This new system, which is being steered by an Empowered Committee of State Finance Ministers and the central government will replace state level VAT and CENVAT. In case of Central GST, central excise duty, additional excise duty, service tax, additional custom duty (countervailing duty), special additional duty, surcharge and cesses would be subsumed with CGST which are at presently levied separately on goods and services by central government. In case

of State GST, VAT/sales tax, entertainment tax, luxury tax, taxes on lottery, betting and gambling, state cesses and surcharges, and entry tax except for stamp duty, toll tax, passenger tax and road tax would be subsumed with SGST which are at present levied separately on goods and services by state government. This will mark a major step in unifying the tax regime across the country and do away with tax arbitrage that currently disturbs investment decisions.

1.3.2 Expenditure Reforms

Continuously growing public expenditure mainly, a high rate of growth of non-developmental expenditure, is the main reason for deteriorating fiscal condition of the central government.

(A) Pre-Reform Period: The problem cropped up in the mid-1970s as public expenditure grew at a higher rate as compared to the growth rate of public revenue. To control the growing rate of public expenditure, a Commission was set up by a resolution of the Government of India on May 29, 1979. But it was wound up on January 31, 1980. In January 1984, a package of measures was taken by the central government with a view to restraining the growth of expenditure. "Plan expenditure was to be reduced by 5 per cent including supplementary grants. Non plan expenditure (excluding interest payments and transfers to States) was cut by 3 per cent" (Economic Survey, 1983-84). Recognizing the gravity of the expenditure problem, a system of zero-base budgeting was initiated in the course of the formulation of the budgets of all central government departments for 1987-88 (Economic Survey, 1986-87).

(B) Post-Reform Period: Efforts were made by the government in 1990-91 to curb built-in–growth in expenditure and to bring about structural changes in the composition of expenditure and effecting economy in non-plan expenditure. Emphasis was also laid on curtailing unproductive expenditure by undertaking a number of measures. These include "monthly budgeting of expenditure in all the departments, cut in the expenditure on staff cars, electricity and telephone bills, and a complete ban on the purchase of new vehicles" (Economic Survey, 1990-91). The government initiated various measures to correct the fiscal imbalance during 1991-92. Such measures mainly were reduction in the fertilizer subsidy, abolition of Cash Compensatory Support for exports, and abolition of subsidy on sugar. Further, the government had

also “imposed 5 per cent cut on the expenditure of all Ministries/Departments. Only a few items of expenditure, such as, statutory grants to state governments, block grants and loans for state Plan schemes, interest payments and pension payments were exempted from the expenditure cut” (Economic Survey, 1991-92). The problem of high rate of growth of non-developmental expenditure persisted for a long time, but the reforms on this front started very late with the beginning of the process of downsizing the government. It was only at the end of the last decade of 20th century and one decade later than the tax reforms process was initiated, i.e., on February 29, 2000, an Expenditure Reforms Commission was constituted. The measure to improve the quality of expenditure includes subjecting all existing schemes to zero-based budgeting and only those that were demonstrably efficient and essential were decided to be retained from 2001-02. The central government has also brought about pension reforms by introducing a new pension scheme with effect from January 1, 2004, for the central government employees by replacing the existing defined benefit pension system. Further in 2006-07, government took a series of initiatives for fiscal reforms like “avoiding rush of expenditure through releases in a time sliced manner and simplification of procedures” (Economic Survey, 2006-07).

1.3.3 Reforms in the Borrowing Process

Growing debt burden and aggravating fiscal crisis have both cause-and-effect relationships. Only a few changes in the process of central government borrowings have been made as a part of the fiscal sector reforms.

1.4 Impact of Public Finance on States

Public Finance impacts the economy in many ways. The impact is both direct and indirect. The impact is direct as the government finances give shapes and direction to the economic policy that the government wants to pursue through planning and programming to achieve various socio-economic goals. It also impacts indirectly through the level and pattern of expenditure as well as the means through which the resources are raised. It is, therefore, considered as a powerful instrument for accelerating economic growth and development.

The overall macro environment is an important factor determining the growth potential of a state. The structural reforms and stabilization policies introduced in 1991 considered fiscal discipline necessary for the attainment of macro-economic balance. The Government set a target for reducing fiscal deficit as proportion of Gross Domestic Product from 8.5 percent in 1990-91 to 5 percent. However, reduction in fiscal deficit at the centre has implications for the state finances. Thus, restructuring at the level of centre is not enough as states in the federal set up of India, are usually taken to be equal partners to the centre in the overall development effort.

States are assigned with important responsibilities in many sectors such as agriculture, infrastructure, poverty alleviation, water supply, irrigation and rural development. Furthermore, they have concurrent jurisdiction in several areas like education, electricity, family planning, economic and social planning. Thus, fiscal discipline at state level is considered necessary to accelerate overall growth and development. The role of the state and its fiscal policy are becoming crucial issues and are receiving greater attention from the economists, despite the fact that the state is expected to retreat from economic activities. For example, one of the themes of the World Development Report of the World Bank (1997) is 'the state in a changing world'. The Report advocates an important role of states in imparting growth and development to an economy.

In India, one important issue at state level or sub-national level is that of fiscal sustainability. Analysts argued that this issue relates to fiscal deficit, revenue deficit, unproductive expenditures and unsustainable subsidies. The composition of receipts and expenditure of the Government sector in India reveals that while the state governments collect about one-third of the total Government sector receipts, they incur more than three-fourths of the total expenditure on social services and more than half of the total expenditure on economic services. Further, as the state government's budgetary support from the central government is gradually reducing, their inability to undertake and perform developmental functions adequately and effectively has become contingent on their fiscal position.

It has been argued that to accelerate economic growth, higher investment is needed in critical social and economic sectors by state governments. However, the financial position of most of the states is actually forcing a continuing squeeze into plan

investment. Thus, in view of larger responsibilities, the present thesis provides an analytical review of the fiscal management of state governments particularly the Gujarat state. It examines the various policy measures undertaken and their effectiveness to improve the fiscal situation.

1.5 THE FISCAL RESPONSIBILITY AND BUDGET MANAGEMENT ACT, 2003

The FRBM Act is a fiscal sector legislation enacted by the Government of India in 2003, aiming to ensure fiscal discipline for the centre by setting targets including reduction of fiscal deficits and elimination of revenue deficit. It is a legal step to ensure fiscal discipline and fiscal consolidation in India. The targets set under the Act were postponed several times in later years though some other goals of the Act including phasing out of government borrowing from the RBI were implemented.

1.5.1 Necessity of FRBM

The FRBM Act was enacted in 2003 as rising government borrowing and the resultant government debts have seriously eroded the financial health of the government. High revenue deficit due to higher expenditure on subsidies, salaries, defence etc. compelled the government to make big borrowing from early 1990s onwards. With inadequate revenues, government resorted to high level of borrowing.

The borrowing again produced high interest payments. In this way, interest payments became the largest expenditure item of the government. To arrest this financial weakness in its budget, the government has taken some serious deficits cut targets by introducing a law in the form of the FRBM Act.

The Act gives slight flexibility to the government regarding the realisation of the target as well. It gives the responsibility to the government to adhere to these targets. The finance minister has to explain the reasons and suggest corrective actions to be taken, in case of breach. The following are the provisions of the Act in detail.

- The government has to take appropriate measures to reduce the fiscal deficit and revenue deficit so as to eliminate revenue deficit by 2008-09 and thereafter, sizable revenue surplus has to be created.
- Setting annual targets for reduction of fiscal deficit and revenue deficit, contingent liabilities and total liabilities.
- The government shall end its borrowing from the RBI except for temporary advances.
- The RBI not to subscribe to the primary issues of the central government securities after 2006.
- The revenue deficit and fiscal deficit may exceed the targets specified in the rules only on grounds of national security, calamity etc.

Though the Act aims to achieve deficit reductions prima facie, an important objective is to achieve inter-generational equity in fiscal management. This is because when there are high borrowings today, it should be repaid by the future generation. But the benefit from high expenditure and debt today goes to the present generation. Achieving FRBM targets thus ensures inter-generation equity by reducing the debt burden of the future generation.

Other objectives include long run macroeconomic stability, better coordination between fiscal and monetary policy, and transparency in fiscal operation of the Government.

1.5.2 Amendments to the FRBM Act

Amendments to the Act were made after its initial version in 2003. This includes revision of the target realisation year and introduction of the concept of effective revenue deficit. In 2012 and 2015, notable amendments were made. As per one provision of the amendment, a "Medium-term Expenditure Framework" statement should be prepared which will set a three-year rolling target for expenditure indicators.

As per the amendments in 2012, the Central Government has to take appropriate measures to reduce the fiscal deficit, revenue deficit and effective revenue deficit to eliminate the effective revenue deficit by the 31st March, 2015 and

thereafter build up adequate effective revenue surplus and thereafter as may be prescribed by rules made by the Central Government.

As per Finance Act 2015, the target dates for achieving the prescribed rates of effective deficit and fiscal deficit (3% fiscal deficit) were further extended by 3 years to March 2018. As per the 2017-18 Budget, the government has extended the timeline for the achievement of the 3% target to 2018-19.

1.5.3 Committee to review FRBM targets

As per the Union Budget 2016-17, the government constituted a committee to review the implementation of the FRBM Act. This was after a widely held view among experts that instead of fixed fiscal deficit targets, it may be better to have a fiscal deficit range as the target. This will help the government to meet specific situations like recessions which demand high government expenditure. There is also a suggestion that fiscal expansion or contraction should be aligned with credit contraction or expansion respectively, in the economy. While remaining committed to fiscal prudence and consolidation, Budget stated that a review of the FRBM Act is necessary in the context of uncertainty and volatility in the global economy.

1.6 Nagaland Fiscal Responsibility and Budget Management (FRBM), Act 2005

The Nagaland Fiscal Responsibility and Budget Management (FRBM), Act 2005, enacted under the 12th FC recommendations. Since 2006, the Act has been amended 4 times in 2009, 2011, 2021 and 2022.

1.6.1 Revenue Deficit: The 2005 Act required the State to remain revenue surplus by making a balance in revenue receipts and expenditure and build up further surplus.

1.6.2 Fiscal Deficit: The initial Act mandated the State to reduce its fiscal deficit-to-GSDP ratio to 3 percent of projected GSDP by the year ending 31st March 2009. The 2009 amendment raised the fiscal deficit to 3.5 percent of the estimated GSDP by 31st March 2010. The 2011 amendment required the State to achieve fiscal deficit of 3 percent of projected Gross State Domestic Product (GSDP)[1] by the year ending 31st

March 2015. The 2020-21 amendment fixed fiscal deficit levels to be – 5 percent in 2020-21, 4 percent in 2021-22, 3.5 percent in 2022-23, and 3 percent 2023-24 onwards.

1.6.3 Debt: Initially the State Act of 2005 mandated the State to ensure that the total debt stock do not exceed 40 percent of the estimated GSDP for that year within a period of 5 years, beginning from the initial financial year on the 1st April 2005, and ending on the 31st March 2010. The 2011 amendment required the State to achieve debt to GSDP ratio of 56.8 percent in 2010-11 and reduce it to 52.3 percent by 2014-15. The 2021 amendment limited the amount of annual incremental risk weighted guarantees to 1 percent of the estimated GSDP of the year preceding the current year. Further the total guarantees at any point of time shall not exceed 5 percent of the estimated GSDP of the year preceding the current year.

1.6.4 Fiscal Discipline: As per the State Finances Audit Report of the Comptroller and Auditor General of India (CAG), during the period from 2017-18 to 2021-22, the State missed achieving the revenue deficit targets only once in five years (2019-20), but fiscal deficit targets thrice (from 2018-19 to 2020-21). And the State also failed to achieve the targeted ratios for the outstanding liabilities for three out of five years (2017-18, 2019-20 and 2020-21) (NITI Aayog, 2025).

1.6.5 Implications of Nagaland FRBMA: Nagaland had enacted the FRBMA in 2005-06 and was able to generate revenue surpluses since then. With FRBMA, its finances have been looking up. The GSDP ratio declined from double digits till 1991 to 2.7 percent, i.e., within the FRBMA limits in 2010-11. Debt-GSDP ratio had also been going down. In 1974-75 the ratio had increased to an unsustainable 77 percent, but had gradually come down to 41.6 percent in 2010-11, which was still a dangerous level. But the State appears to have emerged from the most vicious debt trap into which it was falling almost irrevocably (Bhattacharjee, 2016).

1.7 THE STATE OF NAGALAND: AN INTRODUCTION

State governments play an important role in economic activities in a federal setup like India. The critical role of state finances in the realignment and restoration of the macro balance in the economy is well recognised particularly in the context of economic restructuring. In a liberalised economic environment, sub-national governments will have to play a relatively more important role than in the past. Fiscal decentralisation is necessary in the wake of empowerment of rural and urban local bodies. This would essentially require the state governments to substantially augment their resources.

Fiscal reforms are necessary, though not a sufficient condition for enabling the state governments to be more effective agents of development. Improving the efficiency, effectiveness and transparency of government's operations is equally important. Reforms at the centre in the early nineties paved the way for sub-national reforms. Unfortunately, this reform process did not pick up until the second half of the nineties when the state level fiscal crisis set in. Several states witnessed a slowdown in their growth rates relative to the level of the eighties. Competition for private investment by the states led to competitive tax concessions and incentives leading to fiscal imbalances in the nineties. Populist policies like free power and irrigation to the farm sector compounded the problem by creating long-term liabilities without corresponding revenue growth, ultimately straining state finances and reducing their capacity to invest in growth-enhancing sectors like infrastructure and education. The states are unable to increase the tax ratio as also improve the productivity of non-tax revenue. Political compulsions do not allow the states to increase user charges (Rao, 2002). The Fifth, Sixth and Seventh Pay Commission awards further led to fiscal deterioration on account of substantial pay increase. The states were also hit by higher interest rates on two counts: the interest rate on loans from Government of India (GoI) to the states was raised towards market rates, increasing the cost of borrowing, and simultaneously, states had to rely more heavily on market borrowings, which carried even higher interest burdens due to their weaker credit profiles and limited fiscal space. This double whammy - rising salary obligations and costlier debt servicing - exacerbated fiscal stress, especially for states already grappling with low revenue buoyancy and politically sensitive expenditure commitments. The result was a

growing mismatch between revenue and expenditure, leading to persistent deficits and mounting debt.

As a matter of constitutional history, the State of Nagaland was born out of a political agreement commonly called as '16-Point Agreement' arrived at between the delegation of the Naga People's Convention and the Government of India in 1960. By this agreement, the territories of the Naga Hills-Tuensang Area created by the Naga Hills-Tuensang Area Act, 1957 was stipulated to form a new state within the Indian Union and be called as State of Nagaland. Ultimately, by the Nagaland State Act, 1962 (Act no. 27 of 1962), the present state of Nagaland came into existence with effect from 01-12-1963. Given the background of the creation of the State of Nagaland, it may be observed that there is no misgiving about the adequacy of own resources of the State. As may be noticed, Clause 11 of the above said 16-Point Agreement speaks of financial assistance from the Government of India and it is recorded in the same Clause that to supplement the revenue of the State, there will be a need for the Government of India to pay the Consolidated Fund of India:

i) Lump sum to meet the cost of development in Nagaland and;

ii) A Grant-in-aid towards the cost of administration.

It may also be observed, as a matter of academic discussion, that the spirit of Clause 11 of the 16-Point Agreement is implicitly incorporated in the Constitution of India, as may be gathered from the reading of Article 371A (1) (c) and 2 (b) of the Constitution (Angami Zelre, 2009).

Considering the various geographical and socio-economic conditions peculiar to a small State like the State of Nagaland, it may be understood that Parliament, in its wisdom, had chosen to provide a special provision in the form of Article 371A of the Constitution in addition to the provision of Article 275 of the Constitution. The question as to the inadequacy of resources had been appreciated by the highest authority of India through the words of Dr. S. Radha Khrishnan, President of India who had addressed the people of Nagaland on the inauguration of the Statehood of the present State of Nagaland on 1st of Dec. 1963 to the extent that the resources of Nagaland limited as they are, will have to be developed to the fullest extent and yet

there may be need for central assistance for the purpose of development and administration and that for sure the assistance will be available for the Naga People in the full measure and that considerable progress had been made in Agriculture, Education, Health Services, Communication etc, but the face of development will have to be speeded up. Despite the fact that the State of Nagaland is presently receiving central assistance as one of the special category states and as one of the North-East States, though not expressly treated in terms of Clause II of the 16-Point Agreement. As may be disclosed from the discussion that may be made hereinafter, it may be observed that the finance of the State Government is still largely dependent on the transfer of resources from the Government of India (Angami Zelre, 2009).

1.7.1 Profile of Nagaland

Nagaland attained statehood on 1st December, 1963 as a special category state. It is one of the states in Northeastern region of India, bounded by three states viz. Assam in the North and West, Arunachal Pradesh in the East and Manipur in the South. The state shares international border with Myanmar in the East. The state's topography is mountainous, and the altitude varies approximately between 194 meters and 3048 meters above sea level. The state has a geographical area of 16,579 square kilometres (0.51 % of the country's area). The State's capital is Kohima town and it has 16 districts as of January 2022, viz, Kohima, Mokokchung, Tuensang, Wokha, Phek, Dimapur, Peren, Longleng, Kiphire, Zunheboto, Mon, Noklak, Tseminyu, Nuiland, Shamator and Chumoukedima. According to 2011 census, it has a total population of 19,78,502 out of which 71.14 % reside in rural areas and 28.86 % in urban areas. The sex ratio is 943 females per 1000 male, with a density of 119 people per sq. km. The state's literacy rate is 79.55 per cent, out of which the male literacy is higher with 82.75 per cent against female rate of 76.11 per cent. Since its statehood, the state has made significant progress, especially in human development front, where the literacy rates are higher than national average and infant and maternal mortality rates are below the national average.

The state is inhibited mostly by tribals, and it has 16 major tribes, viz., Angami, Ao, Lotha, Sumi, Konyak, Rengma, Chakesang, Khiamniungan, Chang, Sangtam, Phom, Yimchungru, Pochury, Zeliang and numerous other tribes and sub-tribes. Each tribe is unique in character with its own distinct customs, language and dresses.

For Local self-governance, Nagaland has institutionalised its traditional village administration system well ahead of the commencement of the Panjayati Raj Act through the Nagaland Village and Tribal Council Act, 1978. Each village has Village Council (VC) that looks after administration and under its ambit Village Development Board (VDB) looks after developmental activities in the village. Enactment of Communitization of Public Institutions and Services Policy, 2002 was an important step towards decentralization of the resource management that opens avenue for community/stakeholders to directly get involved in planning, management, supply of basic services like education, health, electricity, water supply etc. (Jamir & Ezung), 2025)

In urban areas, the Urban Local Bodies (ULBs) of the municipal councils and town councils, which were responsible for providing basic services and resource mobilization at the grass root level, remained inactive for nearly two decades due to the absence of election. The Fist State Finance Commission", under the Chairmanship of Justice (Rtd.) Zelre Angami, which submitted its report in October 2009, had also recommended the allocation of resources to the ULBs. But due to the ad-hoc Town Council members being appointed by the state government, the sharing of resources, especially central and state share of grants-in aid etc. were not properly made. Hence the same is not studied and researched in this thesis. However, on 26th June 2024, it was reactivated with the holding of election for ULBs and shifting of responsibilities to the elected members by the administration. These grass root institutions need sufficient funds for more effective and inclusive growth. In recent years these local bodies, especially in the villages, have been assuming more active roles in carrying out a number of centrally sponsored programmes.

1.7.2 Socio-Economic Background

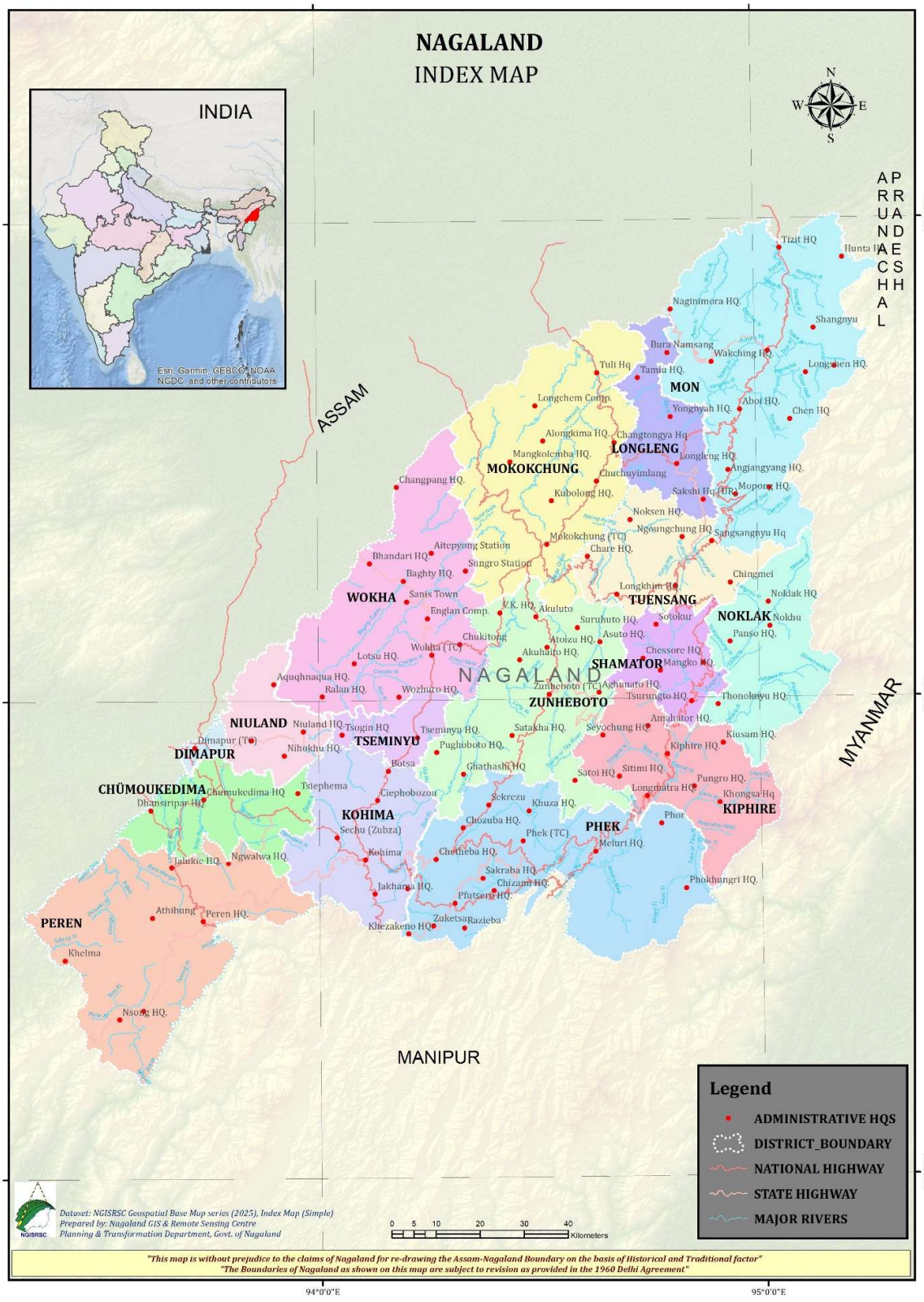
Nagaland is a less developed state in northeast of India (bordering Assam, Arunachal Pradesh, Manipur and Myanmar) with an area of about 16,579 sq. km (mostly hilly terrain) and population of nearly 2 million (2001 census). The rural population is little over 82 percent and spread over large number of scattered villages with poor road access and communications. The Index map of Nagaland is shown in Figure 1.5.

1.7.3 Village Councils (VCs) and Village Development Boards (VDBs)

The village councils were given statutory status in 1978 through the enactment of The Nagaland Village and Area Councils Act 1978. Each village council includes traditional leaders like the 'gaon burrahs' and other representatives from all the 'khels' of the village.1 VC's tenure is five years after which it has to be re-nominated. The village councils operate roughly 1,049 VDBs, which have been constituted with all permanent residents of the village as members. VC selects VDB management committee for a three-year period, including a secretary who is paid a monthly honorarium for assisting VDB and VC. The Deputy Commissioner/Addl. DC is the Chairman of VDBs within the district/sub-division. While VC is a part of the traditional milieu of Naga society, VDB is an effort at dovetailing the village council into development framework. VC has a strong recognition rooted in tradition and is able to exercise influence on traditional spheres of land and family disputes, social and cultural sanctions, etc. However, it has not been so successful in steering VDB for control over development resources and activities. According to a reported field study, the demands of the underground, demands of corrupt coalition, and inclination of the local leadership combine in such a way as to leave only about 40 percent of resources for development programmes. Thus, traditional micro institutions in Nagaland have demonstrated both strength and weakness over the years.

The state has a long history of participative democracy based on traditional Village Councils, well in advance of the decentralisation process in the rest of India. These councils have under their control Village Development Boards, which execute development projects of the government of Nagaland and the government of India, and also run a number of commercial projects.

Figure 1.5: Latest Map of Nagaland



Christian missions over the last century had a major impact on Naga life with many tribal practices given up in favour of Christian practices. Apart from religion, this has impacted very strongly on another aspect of Naga life, namely, literacy and education. According to 2001 census, the state has a literacy rate of 67 percent as compared to the national average of 65 percent.

Nagaland has considerable unutilised mineral, petroleum and natural gas resources and is uniquely placed to provide a critical future industrial and trade linkages with the country's eastern neighbours and Southeast Asia. It also has a large potential for agro-forestry, horticulture and the development of its diverse biological resources.

The state has virtually no private sector and is besieged with a long history of sick state enterprises. General perception, both within the government and the public at large, is not in favour of corporatisation/privatisation of the state's departmental activities.

The economic development of Nagaland has suffered immensely due to prolonged political turbulence. In recent years, the situation has improved a lot on account of ongoing political talks and negotiations. The GSDP at current prices has grown at a compound annual growth rate of 15.9 percent over the last couple of years, and the state is now poised for economic transformation. However, the availability of basic infrastructure, including adequate and reliable power supply, would be crucial for the development of the state.

1.7.4 Communitization

By tradition and culture, Nagaland has very rich social capital in the form of community spirit and community action as a way of life. The micro institution like Village Council is a part of that traditional milieu of Naga society. VC has a strong recognition rooted in tradition and is able to exercise influence on every aspect of village life, including traditional spheres of land and family disputes, social and cultural sanctions, and so on.

However, for various reasons, community spirit and community participation in the all-round development of the people and the society have declined over the years. Recognising this trend, the state government of Nagaland has taken initiatives to revive and utilise the age-old tradition and practice of community participation at the grass-root level in the entire process of development.

The government's effort has eventually taken the shape of communitisation of public institutions and services in such sectors as education, health, and electricity. And to strengthen the process of communitisation, the government enacted the Nagaland Communitisation of Public Institutions and Services Act, 2002

Communitisation of a government institution means transferring the ownership to and sharing responsibility of its management with the community. It thus includes decentralisation of authority, delegation of responsibility, empowerment of the community, and building up of a synergistic relationship between the government and the community for growth and development of the institutions and their service delivery

The 73rd and 74th Constitutional Amendments do intend to transfer powers to the Panchayati Raj institutions to administer sectors such as primary education and health, but the process of empowerment of community in Nagaland is unique in the sense that no other state in the country has enacted communitisation Act, or amended government rules and procedure to transfer salary of the government employees (under control of the community) to the community account in advance.

In 2002, the state initiated the process of communitisation for elementary schools and rural health sub-centres. Being encouraged by visible improvements, GoN has now extended the programme to the power sector.

1.8 State Finances of Nagaland

Over the last couple of years (1999-00 to 2003-04), the revenue receipts have grown at a faster rate (CAGR of 20.2 percent) compared to revenue expenditure (CAGR of 12.3 percent) as a result of which the state had revenue surplus of Rs.547 crores in 2003-04 and Rs.202 crores (BE) in 2004-05. However, this seemingly comfortable position in revenue account hides the most fundamental fiscal weakness of the state. GoN is almost entirely dependent on central transfers (share in central taxes and grant-in-aid) for financing its revenue expenditure. The state's own resource (tax and non-tax revenue) constitutes, on average, around 7 percent of the total revenue receipts and it is quite inadequate to meet major expenditure heads. For instance, own resource cannot meet even annual interest burden; the average interest-to-own revenue ratio works out to be 197 percent.

On the expenditure side, the pension burden has grown at a CAGR of 30 percent and currently soaks about 109 percent of the state's own resources. This is an area of great concern, and the state needs to focus on pension reforms. The central government has already initiated a move to switch over from the present guaranteed non-contributory pension scheme to contributory scheme. The move is being contemplated to tide over the unsustainable fiscal burden on account of pension liability. Like other northeastern states, government employment in the public sector is the major source of income for the people in Nagaland and pension is the only means of social security to them.

Though the annual capital expenditure has grown over the years to Rs.554.5 crores in 2004-05 (BE), it remains far below the level of investments required for the economic development in the state. But, unlike several other states, almost the entire part of the state's borrowing, including loans from GoI, goes toward financing the capital expenditure - the borrowed funds are seldom utilised for meeting revenue expenditure. This is a welcoming fiscal trend, and this has been possible due to the fact that central transfers take care of the revenue expenditure.

In terms of overall borrowing, the state's indebtedness has grown significantly; outstanding debt now accounts for over 52 percent of GSDP. Annual fiscal deficit has been around 6 percent of GSDP (except for 2003-04). This is not an alarming level of deficit, but it is not a comfortable fiscal position too. Both the centre and the state must now realise that further capital investment in the economy would be possible only through augmentation of state revenue and grants and not with debt financing.

In sum, the state government is urgently required to draw up its agenda for fiscal reforms, which must *inter alia* include restructuring some of its loss-making departments such as the Department of Power (DoP), Nagaland State Transport (NST) etc. The state can no longer bear the growing fiscal drain on account of loss-making departments.

1.9 STATEMENT OF THE PROBLEM

Nagaland in the Northeastern part of India is an economically backward state. The state's fiscal needs and responsibilities are very much governed by the exogenous factors such as difficult geographical terrain, long international border etc. Nagaland

is primarily an agrarian economy with more than 60 percent of the population dependent on agriculture for their livelihood.

As per the Economic Survey of Nagaland 2015-2016, conducted by the Department of Economics, Nagaland University the per capita income of the state is Rs.98,816 in 2015-16. As per the Advance Estimates of GSDP current at Market Prices, the Per Capita GSDP in 2015-16 is estimated to increase by 14.55 per cent thereby raising the PCI from Rs.86,264 in 2014-15 (Q.E) to Rs.98,816 in 2015-16 (Adv.E). During the same period, the Per Capita Net State Domestic Product current at Market Prices registered a growth of 15.83 per cent in 2015-16 (Adv.E) as against 10.71 per cent achieved in 2014-15 (Q.E). Corresponding to the increase in the growth rate, the PCI NSDP current at Market Prices has also increased from Rs.76,679 in 2014-15 (Q.E) to Rs.88,818 in 2015-16 (Adv.E).

Due to economic backwardness and poor infrastructural facilities, private investors are reluctant to invest in the state. As such economic development of the state is very much dependent on government investment. As a result, government has to invest in all those crucial sectors that are considered significant for the state. But as is the case with economically backward states, Nagaland has limited resources to discharge its expenditure responsibilities. Any imbalance between the revenue and expenditure responsibilities may push the state into deep fiscal crisis. Fiscal deterioration is not the result of fiscal operation in one or two years, but it is culmination of problems accumulated over the years. The occurrence of fiscal crisis may force the state to undertake different reforms measures. Fiscal reforms as undertaken by different governments to restore fiscal balance is not a simple issue of enhancing revenues and controlling expenditure, rather it is a much more complex issue. Reforms or commitments on the part of the government need to be considered not just in the current year but in future years as well.

Thus, a roadmap for corrective measures will have to be drawn up carefully in the medium term or long term. These issues are very relevant for a state like Nagaland as reduction of expenditure in priority sectors may have serious implications on quality of expenditure of the state. At the same time, continuation of fiscal imbalances may

create the problem of fiscal and debt unsustainability. The government of Nagaland has to design an appropriate fiscal plan to discharge its obligations efficiently considering both present and future implications. Under these circumstances, there is a need to make a detailed analysis of the state finances encompassing all the above issues. With this objective in mind, the present study is taken up to examine the overall fiscal health of the state for twenty years period of post-reform years.

1.10 OBJECTIVES

1. To study the impact of reforms on public expenditure.
2. To study the impact of reforms on Fiscal and Debt Sustainability of the state.
3. To assess the fiscal scenario of Nagaland during the post- reform period on the revenue generation efforts of the government.
4. To evaluate and compare the trends and patterns in the revenue, expenditure indicators after the implementation of Nagaland Fiscal Responsibility and Budget Management Act, 2005.

1.11 HYPOTHESES

1. There is no significant impact of fiscal reforms between the pre and post Nagaland Fiscal Responsibility and Budget Management Act, 2005.

2. Fiscal consolidation measures adopted by the State government to correct fiscal imbalances have ensured fiscal stability in the state.

1.12 METHODOLOGY

The study is based on secondary data. Data pertaining to the study is collected from various reports and publications of different governments and other organisations such as the Directorate of Economics and Statistics, Government of Nagaland; Central

Statistical Organisation; Comptroller and Auditor General (CAG); National Income Statistics; Reserve Bank of India; Ministry of Finance, Government of India; Budget Reports of the Government of Nagaland; Office of the Registrar General and Census Commissioner, India etc. While collecting secondary data, due attention is given on reliability and authenticity of data. Reliability of the data is tested by applying suitable statistical tools.

The data from the reports of the Comptroller and Auditor General of India (CAG) specifically the State Finances, Audit Report of the CAG for the Government of Nagaland has been extensively used in the thesis for study and analysis. CAG reports have been attracting wide media coverage and debates in recent times, but they still do not occupy much space in serious academic literature in the country. They are highly technical in nature, have an extreme obsession for facts and figures and follow a standard templatized style of reporting. But beneath the veneer of their objectivity, they capture and reflect the trends and practices in contemporaneous society rather accurately (Battacharjee, 2016).

In studying the fiscal health of the states, comparison is made with other state governments as well as states as aggregates. Selective comparison with some of the Special category states of the country has been made so as to have a better idea of fiscal health and fiscal management.

The annual and compound growth rates of different variables will be computed to have an idea about the relative performance of the state in the decades. It also gives an idea about the impact of the reform measures on the performance of the state which was carried out in the later part of 2000s.

Calculation of Compound Annual Growth Rate (CAGR) in MS Excel

*CAGR = ((ending value/beginning value)^(1/number of years) – 1) * 100*

The buoyancy coefficients of selected revenue and expenditure categories is computed by dividing the growth rate of total expenditure by growth rate of GSDP.

Tax Buoyancy = (Percentage change in tax revenue) / (Percentage change in GSDP)

Simple linear regression analyses using STATA 17 were carried out to study the revenue effort of the state government including the relevant capacity factors that are likely to have an impact on revenue generation of the state. Two regression analyses were carried out to examine the relationship between Nagaland's Gross State Domestic Product (GSDP) and two key expenditure components: revenue expenditure and capital outlay. To analyse the relative growth of development expenditure with respect to both total and aggregate expenditure of the state, a regression analysis was carried out by regressing development expenditure to total and aggregate expenditure of the state.

Domar model is used to assess the solvency of public debt or Debt sustainability of the state based on CAG data.

Formula:

$$\frac{\Delta D}{Y} = \frac{(r-g)D}{Y} + \frac{G-T}{Y}$$

Multiple Regression Analysis using STATA 17 was done to evaluate the GSDP on Total Revenue, Total Expenditure, and Total Debt (Model 1) and GSDP on Fiscal Deficit, Revenue Deficit and Primary Deficit (Model 2) which were depicted in the concluding chapter.

1.13 RESEARCH GAP

After an extensive review of literature, it is found that there is no study done so far on the impact of Fiscal Reform on selected fiscal indicators of Nagaland and analysis of pre and post reform period. This is an effort to study the fiscal situation in Nagaland and to analyse how far the Nagaland Fiscal Responsibility and Budget Management Act, 2005 has been sincerely implemented and how the implementation of this act has affected the fiscal parameters of the state.

In this thesis an attempt is made to analyse the fiscal reforms undertaken by the central government (Government of India) and its impact on the State of Nagaland. Fiscal

reforms have been analysed under the broad heads of: (i) Revenue reforms, (ii) Expenditure reforms, and (iii) Reforms initiated for Fiscal and Debt Sustainability of the State.

1.14 CHAPTER SCHEME

A modest attempt is made in this thesis with the following objectives in mind: to assess the impact of fiscal reforms on fiscal performance of the state government and to compare revenue, expenditure and borrowing position of the state government in the post-reform period. The fiscal performance of the state government of Nagaland for the period of 2000-01 to 2019-20 has been analysed. The thesis is divided into five chapters. **Chapter 1** deals with the introduction and literature review**. Chapter 2** presents the impact of reform on the Pattern of Revenue Generation. **Chapter 3** reveals the Pattern of Public Expenditure and its implications of Fiscal Reform. **Chapter 4** examines the impact of reform on Fiscal and Debt Sustainability of the State. The summary and conclusions of the study are given in Chapter **5.**

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[2]***Gross State Domestic Product (GSDP)*** *is the value of all the goods and services produced within the boundaries of the State in a given period of time. The Gross State Domestic Product is classified under three broad Sectors such as Primary, Secondary and Tertiary and is compiled economic activity-wise as per the methodology prescribed by Central Statistics Office (CSO), Government of India (GoI) and furnished to Ministry of Statistics and Programme Implementation. Moreover, GSDP is the sum total of value added by different economic sectors (Agriculture, Industry and Services), which form three broad sectors, produced within the boundaries of the State calculated without duplication, during a year. It is one of the measures of economic growth for a State's economy.*

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CHAPTER 2

IMPACT OF REFORM ON THE PATTERN OF REVENUE GENERATION

State governments of developing countries like India face many challenges in the process of achieving the goal of economic development. One of the major challenges faced by state governments is appropriate revenue generation to shoulder various social and economic functions. Analysis of socio-economic profile of Nagaland made in the last chapter found out some priority areas which can significantly contribute to further development of state economies if they get adequate attention. Nagaland did not witness transformation of its economies from agrarian to industrial as compared to other states due to some constraints. Similarly, social sector development of the state was not commensurate with its economic development. There is need of adequate revenue generation as well as cuts in unproductive expenditure so that thrust areas can get proper allocations. It can be said that the level of socio-economic development of a state depends on its revenue raising capacity. Because without adequate revenue generation the government cannot complete its commitment towards various expenditure responsibilities bestowed upon it. So, it becomes crucial to undertake detailed analysis of the state's revenue pattern.

Under the seventh schedule of the Indian Constitution, clear division of revenue resources and expenditure responsibility between union and state governments has been made. The taxes having an interstate base are under the legislative jurisdiction of the union government while those with a restricted base are under the jurisdiction of the respective states. The residuary power, if any, vesting upon the union government. Among the 13 types of taxes vested with the central government, the most important are taxes on income other than on income from agriculture, corporate tax, customs duties and excise duties. Among the taxes placed under the control of state governments are direct taxes on land and agricultural income, excise duties on alcohol and on certain other goods, sales tax on all goods but newspapers, taxes on mineral rights, taxes on vehicles, taxes on sale of electricity and various others. This assignment of taxes is biased towards the Centre as most of the broad-based taxes have been under the ambit of the central government. State governments are having major functions like public health, education, social security, agriculture and`q1e industries

while having only sales tax as a major revenue source. Beside it, differences in revenue generating abilities existing in India also caused the horizontal imbalances. It further results in variations in per capita income, level of employment and level of socio-economic development.

This arrangement of revenue and expenditure functions has vested the state governments with responsibility for efficient resource utilization. State governments must exploit the available revenue resources up to their full capacity. Only through efficient resource management can states fulfil their commitment towards socioeconomic development. Moreover, it is not only the quantity of receipts that matters; quality of receipts has also greater implication for state finances. With this background, this Chapter seeks to examine the revenue pattern of Nagaland. An attempt is also made to identify the reasons for the distinction in revenue performance of the state. For the analysis of relative revenue performance, buoyancy coefficients and tax effort indices have been calculated.

Aggregate receipts are classified as revenue receipts and capital receipts. Revenue receipts are of current nature while capital receipts are of investment nature having future liabilities. Capital receipts include internal debt of the State Government, loans and advances from Centre, recovery of loans etc. Revenue receipts are further classified in tax and non-tax revenue. Tax revenue may again be classified into direct and indirect taxes. Indirect taxes levied by state government are VAT, excise duty, goods and passenger tax, entertainment tax etc. Land revenue, stamp duty and registration fee, electricity duty are direct taxes.

Twelve years after the implementation of value added tax (VAT) in 2005, India rolled out the goods and services tax (GST) on July 1, 2017. The GST is a destination-based single tax on the supply of goods and services by manufacturers to the consumer. The Nagaland Goods and Services Tax (GST) Act, 2017 was passed by the State Legislature in May 2017 and made effective from 01 July 2017 in the State.

This Chapter is divided into five sections. The first section comparatively analyses the own revenue receipts of the State Governments in detail. The second section put some light on issue of dependence of state governments on resource transfers from Centre.

The third section estimates the tax effort index of the state, which helps us to know whether states are exploiting the resources up to their full capacity or not. The fourth section focuses on total own receipts of a state consisting of both revenue receipts and capital receipts of the State Government. Section five deals with the revenue efforts of the state government by applying statistical tools and analysis like measurement of tax-GSDP ratio, Buoyancy of revenue and regression analysis.

2 Analysis of Revenue Receipts

An analysis of revenue and capital receipts of the State Government helps us to know the extent to which the Government is able to meet its requirements from current revenue. It also shows how much amount the Government receives from other sources like loans and advances from Central Government, market borrowings, recovery of loans etc. The analysis helps us to explain that the tax structure of the State Government is regressive or progressive i.e., a major share of tax revenue comes from direct taxes or indirect taxes. We can also estimate the flexibility of the state's revenue resources by tracing its dependence on resources received from central government. The higher dependence of state upon central transfers reveals its inflexibility of additional revenue generation. Besides this, calculation of buoyancy and tax effort index explain the efficiency in revenue mobilisation by respective state governments.

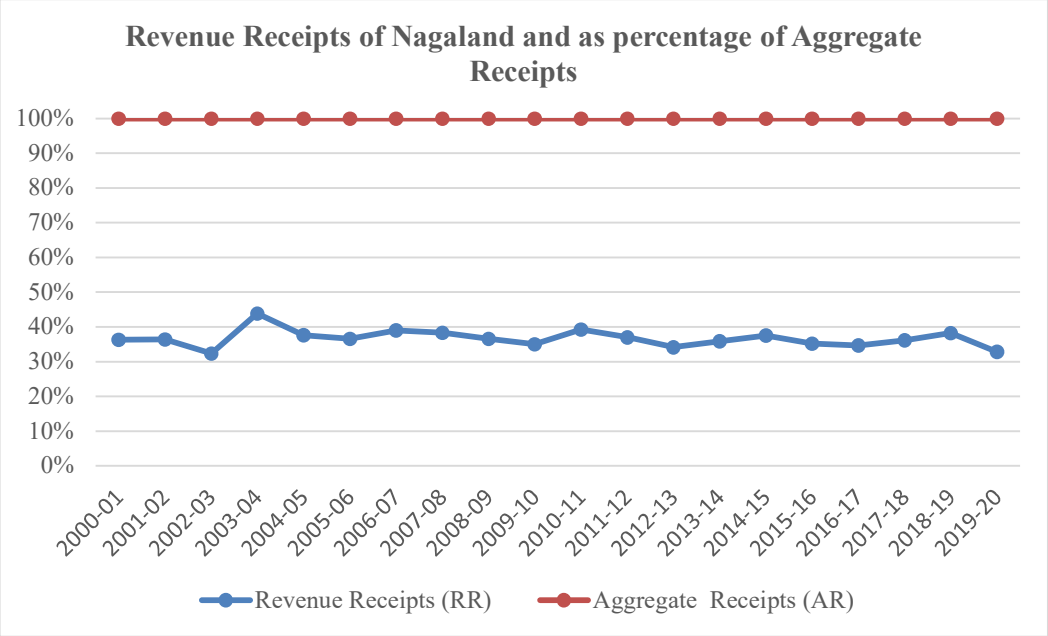
Table 2.1
Revenue Receipts of Nagaland and as percentage of Aggregate Receipts
(Rs. in Crore)

Year	Revenue Receipts (RR)	Aggregate Receipts (AR)	RR as percentage of AR
2000-01	1254.10	2198.39	57.05
2001-02	1324.53	2313.90	57.24
2002-03	1346.90	2818.27	47.79
2003-04	2359.79	3021.86	78.09
2004-05	1839.52	3047.05	60.37
2005-06	2267.20	3925.16	57.76
2006-07	2772.51	4341.26	63.86
2007-08	2996.02	4822.78	62.12
2008-09	3400.89	5896.41	57.68
2009-10	3719.76	6902.67	53.89
2010-11	4998.46	7731.65	64.65
2011-12	5584.62	9517.29	58.68
2012-13	6202.33	11974.96	51.79

2013-14	6495.67	11603.18	55.98
2014-15	7648.67	12726.17	60.10
2015-16	8040.79	14813.35	54.28
2016-17	9439.79	17819.22	52.98
2017-18	11019. 21	19480.86	56.56
2018-19	11437.41	18459.94	61.96
2019-20	11423.29	23372.46	48.88

Source: C&AG Audit Report on State Finances (Various Reports)

Figure 2.1



From the Table 2.1 and Figure 2.1 above the revenue receipts increased considerably in 2003-04 as compared to the previous year (75.20 percent) from Rs. 1346.90 to Rs. 2359.79 crore. However, the same reduced over the next two years 2004-05 and 2005-06. Also the revenue receipts decreased in 2019-20 from Rs. 11437.41 to Rs. 11423.29 as compared to previous year 2018-19.

Revenue receipts increased by Rs. 586.16 crore (11.73 per cent) from Rs. 4998.46 crore in 2010-11 to Rs. 5584.62 crore in 2011-12 due to increase in grants from Government of India (GOI) (Rs.346.28 crore). The revenue receipts at Rs. 5584.62 crore was, however, lower than the assessment made by the State Government in its Fiscal Consolidation Roadmap (FCR) (Rs. 5777.64 crore) for the year 2011-12 by Rs. 193.02 crore.

Revenue Receipts increased by Rs. 617.71 crore (11.06 per cent) from Rs. 5584.62 crore in 2011-12 to Rs 6202.33 crore in 2012-13 due to increase in grants from Government of India (GOI) (Rs. 394.68 crore).

Revenue Receipts increased by Rs. 293.61 crore (4.73 per cent) from Rs. 6204.29 crore in 2012-13 to Rs. 6497.90 crore in 2013-14 due to increase in grants from Government of India (GOI) (Rs.206.64 crore), State's share of Union taxes and duties (Rs.84.13 crore), and State's Non-Tax revenue (Rs. 9.40 crore) offset by decrease in State's Own Tax revenue (Rs. 6.56 crore). The revenue receipts at Rs. 6497.90 crore was however, lower than the assessment made by the State Government in its Fiscal Consolidation Roadmap (FCR) (Rs. 7665.44 crore) for the year 2013-14 by Rs. 1167.54 crore.

Revenue Receipts increased by Rs. 392.63 crore (5.13 per cent) from Rs. 7650.94 crore in 2014-15 to Rs. 8043.57 crore in 2015-16 due to increase in grants from State's share of Union Taxes and Duties (Rs. 1478.04 crore) and State's Own Tax Revenue (Rs. 38.49 crore) and offset by decrease in grants from Government of India (GOI) (Rs. 1109.68 crore) and State's Non-tax Revenue (Rs.14.22 crore).

Revenue Receipts increased by Rs. 1398.71 crore (17.38 per cent) from Rs. 8043.57 crore in 2015-16 to Rs. 9442.28 crore in 2016-17 due to increase in grants from State's share of Union Taxes and Duties (Rs. 491.49 crore).

Revenue Receipts (RR) as the percentage of Aggregate Receipts (AR) was highest in 2003-04 at 78.09 percent and lowest just before that year in 2002-03 at 47.79 percent. Revenue Receipts were ₹ 11,423.29 crore during 2019-20, which decreased by ₹ 14.12 crore (0.12 per cent) compared to the previous year.

2.1 COMPOSITION AND TREND OF TOTAL REVENUE OF THE STATE

2.1.1 Composition of Revenue of the State:

As the study period includes two decades, decade wise compound growth rate of different sources of revenue of the state has been computed. This gives an idea about comparative performance of the state in the two decades taken for the analysis. The time series data on composition of revenue receipts of the state provides information

on the revenue generation capacities of the state and also the dependence of the state on central transfers. The share and compound growth rate of different sources of revenue of Government of Nagaland has been provided in table 2.2.

Table 2.2
Composition of different Revenue Receipts of Nagaland during 2000-01 to 2019-20

(Rs. in Crores)

Year	Tax Revenue	Non-Tax Revenue	Share in Central Taxes	Grants-in-aid	Total
2000-01	46.25	39.23	96.48	1072.14	1254.10
2001-02	54.90	43.41	30.71	1195.51	1324.53
2002-03	62.00	43.94	46.01	1194.95	1346.90
2003-04	68.55	60.91	256.97	1973.36	2359.79
2004-05	78.31	77.90	160.15	1523.16	1839.52
2005-06	105.53	96.82	248.5	1816.35	2267.20
2006-07	119.02	91.14	316.93	2245.42	2772.51
2007-08	131.37	119.48	399.77	2345.40	2996.02
2008-09	156.02	180.55	421.84	2642.48	3400.89
2009-10	180.51	126.35	434.03	2978.87	3719.76
2010-11	227.32	183.14	689.46	3900.07	4999.99
2011-12	303.88	232.95	803.20	4246.35	5586.38
2012-13	339.95	207.17	917.14	4740.03	6204.29
2013-14	333.39	216.57	1001.27	4946.67	6497.90
2014-15	388.61	270.61	1062.68	5929.04	7650.94
2015-16	427.10	256.39	2540.72	4819.36	8043.57
2016-17	510.75	345.52	3032.63	5553.38	9442.28
2017-18	638.28	388.53	3353.13	6639.27	11019.21
2018-19	846.43	255.24	3792.41	6543.33	11437.41
2019-20	958.23	339.29	3267.08	6858.69	11423.29
CAGR 2000-01 to 2009-10	**17**	**17**	**22**	**14**	**15**
CAGR 2010-11 to 2019-20	**15**	**6**	**17**	**6**	**9**
CAGR 2000-01 to 2019-20	**16**	**11**	**19**	**10**	**12**

Sources: State Finances, Audit Report of the Comptroller and Auditor General of India (various reports)

It is evident from table 2.2 that total revenue of the state government has increased from Rs.1254.10 crore in 2000-01 to Rs. 11,423.29 crore in 2019-20. The compound growth rate of total revenue is found to be 12 percent for the above time period. The own tax revenue of the state government has increased from Rs. 46.25 crore in 2000-01 to Rs. 958.23 crore in 2019-20. The compound annual growth rate of own tax revenue during the study period is found to attain the highest value of 16 percent among the all categories of revenue. For the same time period, non-tax revenue of the state has increased from Rs.39.23 crore in 2000-01 to Rs. 339.29 crore in 2019-20 with a compound growth rate of 11 percent. Similarly, shared taxes and grants-in-aid have increased from Rs.96.48 and Rs. 1972.14 crore in 2000-01 to Rs. 3,267.08 and Rs. 6,858.69 crore respectively in 2019-20. The compound growth rate of these two sources of revenue is found to be 19 percent and 10 percent respectively during the above-mentioned period. The compound annual growth rate (CAGR) of total revenue is found to be higher in the first decade of the present century than in the present decade. The CAGR during the time period 2010-11 to 2019-20 was 9 percent only as compared 15 percent for the time period 2000-2001 to 2009-10. The compound growth rate of tax and non-tax revenue of the state is found to be 15 percent and 6 percent during the time period 2010-11 to 2019-20 compared to 17 and 17 percent respectively in the previous decade. Similarly, the growth rate of central transfers in terms of shared taxes and grants-in-aid has experienced a growth rate of 17 and 6 percent during the time period 2010-11 to 2019-20 compared to 22 and 14 percent respectively during 2000-01 to 2009-10. It is also necessary to examine the percentage contribution of different revenue sources towards state government's exchequer to examine the significance of each source of revenue.

2.1.2 Share of Different Sources of Revenue of the State

The composition and percentage contribution of the above-mentioned revenue sources speak about the dependence of the state on central transfers. The higher proportion of own resources compared to central transfers gives the state the required flexibility to undertake different developmental works at its own discretion. The percentage contribution of different components of revenue of the state has been provided in table 2.3.

Table 2.3
Percentage contribution of different sources of Revenue Receipts of Nagaland during 2000-01 to 2019-20

(In Percentage)

Year	Tax Revenue	Non-Tax Revenue	Total Own-Revenue	Share in Central Taxes	Grants-in-aid
2000-01	4	3	7	8	85
2001-02	5	3	8	2	90
2002-03	5	3	8	3	89
2003-04	3	3	6	11	84
2004-05	4	4	8	9	83
2005-06	5	4	9	11	80
2006-07	5	3	8	11	81
2007-08	5	4	9	13	78
2008-09	5	5	10	12	78
2009-10	5	3	8	12	80
2010-11	5	4	9	14	78
2011-12	6	4	10	14	76
2012-13	6	3	9	15	76
2013-14	5	3	8	16	76
2014-15	5	4	9	14	77
2015-16	5	3	8	32	60
2016-17	5	4	9	32	59
2017-18	6	4	10	30	60
2018-19	8	2	10	33	57
2019-20	8	3	11	29	60

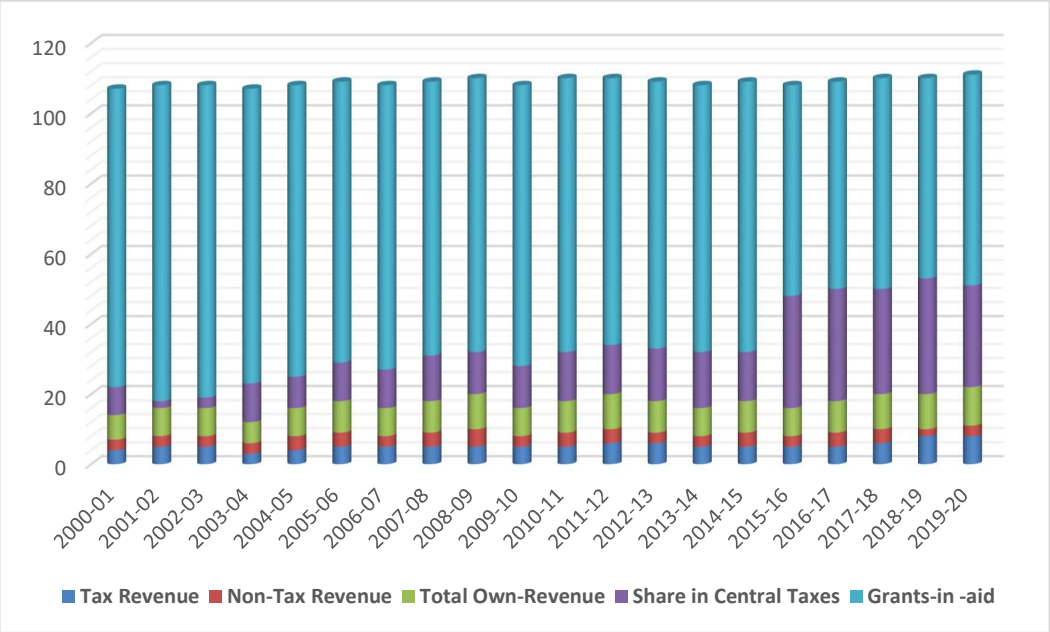
Source: State Finances Audit Report of the Comptroller and Auditor General of India

It is evident from table 2.3 that central transfers constitute a major portion of the state's total revenue during the study period. It has been noticed that the central transfers, on an average, constitute more than 90 percent (average of total years) of the total revenue receipt during of period of study. The dependence of the state on central transfers remains more or less same during the study period. In the year 2019-20, central transfers contributed 89 percent of the total revenue compared to 93 percent in the year 2000-01. Over-dependence of the state on central transfers reflects the inability of the state to undertake developmental activities with its own resources. The percentage contribution

of each sources of revenue is also shown in figure 2.1. Figure 2.2 shows percentage contribution of own revenue and central transfers to totalrevenue at an aggregate level.

Figure 2.2

Percentage contribution of different sources of Revenue Receipts of Nagaland during 2000-01 to 2019-20



It can be seen from figure 2.2 that grants-in-aid has been a significant source of state's total revenue during the study period. Among the own revenue, tax revenue is found to be major contributor for the period taken for the analysis. It is clearly evident from figure 2.2 that central transfers constitute the major portion of total revenue of the state for the period considered for the analysis. A fall in central transfers may lead the state into fiscal imbalances. Under these circumstances, it is necessary to examine the dependence of the state on central allocation in comparison to other states in India.

2.1.3 Ratio between Own Resources and Revenue Receipt:

To have an idea about the comparative position of the state on dependence on central transfers, the whole time period is divided into four sub-periods by taking five year average of the parameter. The improvement index is computed as a percentage of change over the previous sub-period to know the improvement of the state in a particular sub-period compared to the previous one. The improvement indices in the

three sub-periods are represented as A, B and C. A indicates the improvement in the sub-period 2005-10 over the sub-period 2000-05. Similarly, B and C indicate improvement in the sub-period 2010-15 and 2015-20 compared to the sub-period 2005-10 and 2010-15 respectively. The relative dependence of the state on central transfers compared to other states of India has been provided in table 2.4.

It appears from table 2.4 that the own resources-revenue receipt ratio of the state is found to be low compared to all states for all the sub-periods considered for the analysis. The comparative performance of the state to that of major states average has been found to be much low for each of the sub-periods. Compared to the rest of the special category states, the performance of the state is found to be still low for all the sub-periods considered for the analysis. The own resources-revenue receipt ratio of the special category states was 26.34 in the sub-period 2000-05 compared to Nagaland's ratio of 7.17. The ratio for the state is also found to be lower than the average ratio of the special category states for the rest of the sub periods. But improvements in the ratio of the state has been noticed during the time period 2005-2010 compared to 2000-05 as well as during 2015-20 compared to 2010-15. On the other hand, improvement in the ratio of the state has been noticed in the time period 2010-15 compared to the time period 2005-10.

The above discussion reveals that the dependence of the state on central transfers is comparatively more than other developed states and the states as aggregates. But the amount transferred to the state government depends upon various factors such as revenue earned by the Central Government and various formulas adopted by various Commissions and ministries of the government. As central transfers constitute the major portion of the state's total revenue, it is necessary to analyze the different sources of central transfers. It is also necessary to examine the guiding principles which actually determine the central allocation to the state governments. The following section examines the guidelines, volume and pattern of central transfers to Assam through different channels of Government of India.

Table 2.4

OWN RESOURCES - REVENUE RECEIPT RATIO OF NAGALAND VIS-A-VIS OTHER STATES OF INDIA

(In Percentage)

Years	Own Resources-Revenue Receipt Ratio						Improvement Index		
	Nagaland		Special Category States		All States of India		Nagaland	Special Category States	All States of India
2000-01	7.04	92.96	23.16	76.84	62.01	37.99	-	-	-
2001-02	6.69	93.31	26.06	73.94	61.87	38.13	-5.33	16.93	-0.59
2002-03	7.18	92.82	28.49	71.51	62.68	37.32	7.89	13.04	3.51
2003-04	7.00	93.00	24.41	75.59	60.25	39.75	-2.70	-18.95	-9.75
2004-05	7.95	92.05	29.6	70.4	62.99	37.01	14.74	30.20	12.29
2005-06	8.95	91.05	28.44	71.56	61.39	38.61	13.82	-5.48	-6.58
2006-07	7.58	92.42	29.46	70.54	60.47	39.53	-16.56	5.08	-3.79
2007-08	8.35	91.65	29.76	70.24	59.28	40.72	11.08	1.45	-4.83
2008-09	9.91	90.09	29.91	70.09	59.05	40.95	20.74	0.72	-0.95
2009-10	8.26	91.74	29.22	70.78	59.83	40.17	-18.15	-3.26	3.29
2010-11	8.20	91.80	27.95	72.05	60.03	39.97	-0.79	-6.03	0.84
2011-12	9.58	90.42	33.26	66.74	60.03	39.97	18.61	28.47	0.00
2012-13	8.81	91.19	30.14	69.86	61.89	38.11	-8.81	-13.43	8.13
2013-14	8.46	91.54	31.98	68.02	62.04	37.96	-4.34	8.98	0.64
2014-15	8.62	91.38	28.43	71.57	58.35	41.65	2.07	-15.51	-14.28
2015-16	8.55	91.45	28.38	71.62	55.06	44.94	-0.89	-0.25	-12.55
2016-17	9.07	90.93	28.29	71.71	53.24	46.76	6.69	-0.44	-7.07
2017-18	12.40	87.60	30.64	69.36	55.97	44.03	41.91	11.98	11.65
2018-19	9.34	90.66	32.93	67.07	55.14	44.86	-27.22	11.14	-3.31
2019-20 (RE)	9.35	90.65	27.36	72.64	54.31	45.69	0.12	-23.29	-3.29

Source: C&AG Reports & RBI Data

2.2 DIFFERENT CHANNELS OF CENTRAL TRANSFERS OF THE GOVERNMENT OF INDIA

Central transfers through different channels such as Planning Commission, Finance Commission and different ministries of the Government of India have played a significant role in solving the problem of vertical and horizontal imbalances between central and state governments in India. The difference in the fiscal capacities of the states is considered to be chief reason for horizontal imbalance among the states governments in India (Fan et al.,2000; Bagchi, 2002). The transfers designed for this purpose are known as general-purpose transfers provided to the state governments to countervail the fiscal disabilities arising from low revenue raising capacities and higher unit cost of providing services for reasons beyond their control. Theoretical literature advances rationale for inter-governmental transfers on horizontal equity grounds or merit goods grounds (Buchanan 1950, Broadway and Flatter 1982). The transfers for providing merit goods are made to ensure that every state spends the prescribed minimum outlay on meritorious services with significant inter-state spillovers. The provision of these services is supposed to equalize the standard of social and physical infrastructure across different states. Additionally, given their generalized externalities, it provides a level playing field to the disadvantaged states (Rangarajan and Srivastava, 2011). The main purpose of reducing the vertical and horizontal imbalances through fiscal transfers in India is to allow the state governments to provide comparable level of services if they undertake comparable efforts to raise revenues (TFC, 2009). The transition of Indian economy from plan to market during 1990s puts even greater burden on the transfer system as it accentuated the imbalances between the poor and rich state governments. In addition, a globalizing environment requires the creation of competitive level of infrastructure to prevent skewed regional distribution of economic activities (Rao, 2010). The transfer mechanism of the federal system in India needs to address all the above-mentioned issues. A notable feature of transfer system in India is the existence of multiple channels such as;

a) Statutory transfers through the Finance Commission.

b) Plan transfers through Planning Commission.

c) Discretionary transfers for Central Sector Schemes and Centrally Sponsored Schemes.

2.2.1 Transfers through the Finance Commissions

The Finance Commission of India is a constitutional body constituted for recommendation of the devolution of proceeds from central taxes to states and grants for their non-plan revenue requirements. All the Finance Commissions in India are basically entrusted with the task of;

a) Distribution between the Union and the States of the net proceeds of taxes which are to be, or may be, divided between them and allocation of respective shares of such proceeds among the states.
b) Devising principles which should govern the grants-in-aid of the revenues of the states out of the Consolidated Fund of India and the sums to be paid to the States which need assistance by way of grants-in-aid of their revenues under article 275 of the Constitution for purposes other than those specified in the provisos of clause (1) of that article.

Finance Commissions in India have adopted different criteria for devolution of shared taxes. Up to the Seventh Finance Commission, the criteria used for determining the income tax shares were clearly distinct from those for the Union excise duties and were given under two separate articles of the constitution, that is, Article 270 and 272. Article 270 had provided for mandatory sharing of income tax while article 272 had provided for sharing of the Union excise duties at the discretion of the centre. After that, a process of convergence between the two sets of formula began. A full convergence had arrived with the introduction of 80th amendment of the Constitution as recommended by the Eleventh Finance Commission. The Constitution (Eightieth Amendment) Act, 2000, significantly changed the manner of distribution of central tax collections between the Central and State governments. Following this amendment, all central taxes were

brought into sharable pool and it becomes mandatory to assign a share from each central tax to the States. The objectives of the Constitution (Eightieth Amendment) Act, 2000 was to construct a pool of all central taxes for sharing so that a holistic view can be taken and both sides could share in aggregates buoyancy of the central tax revenues (Sury, 2010). On the other hand, grants provided by the Finance Commissions in India are basically for non-plan revenue requirement.

As the study pertains to the time period from 2000-01 to 2019-20, the analysis has been confined to the recent Finance Commissions such as Eleventh, Twelfth, Thirteenth and Fourteenth Finance Commission. The Finance Commissions which are considered for analysis are unique in the sense that unlike the previous Finance Commissions, they have applied the same formula for distribution of both Income tax and Union excise duties. The Finance Commissions of India use different criteria such as population, income (distance method), area, index of infrastructure, tax effort, fiscal discipline and fiscal capacity distance etc. for distribution of resources among the states in India. The criteria used by the recent Finance Commissions for devolution of shared taxes among the states have been given in table 2.5.

Table 2.5

CRITERIA FOR INTER-STATE SHARING OF INCOME TAX AND UNION EXCISE DUTIES BY FINANCE COMMISION OF INDIA (IN %)

Finance Commission → / Criteria ↓	X FC	XI FC	XII FC	XIII FC	XIV FC	XV FV
Population	20	10	25	25	17.5	15
Demographic Performance					10	12.5
Income distance	60	62.5	50		50	45
Inverse Income						
Poverty/Backwardness						
Area	5	7.5	10	10	15	15
Index of Infrastructure	5	7.5				

Tax Efforts	10	5	7.5			2.5
Fiscal Discipline		7.5	7.5	17.5		
Fiscal Capacity Distance				47.5		
Forest and Ecology					7.5	10

Source: Finance Commission Reports

From the table 2.5, it is evident that the recent Finance Commissions of India have applied different criteria for devolution of shared taxes between the states in India. The weight assigned to the above criteria has a profound impact on the revenue transfer to the states. The Tenth Finance Commission of India devised a unifying formula for inter-state distribution of both Income tax and Union excise duties and a portion of the Union excise duties was kept aside for distribution according to 'assessed deficits'. The Eleventh, Twelfth and Thirteenth Finance Commission of India adopted a unified formula for the distribution of Income tax and Union excise duties. The above criteria as given in table 2.5 jointly reflect four considerations: (a) vertical transfers; (b) horizontal equity, (c) incentives for efficiency, (d) cost disadvantages. The criteria which have been used by the Finance Commissions for horizontal equity are income distance, inverse-income formula, poverty ratio and index of backwardness etc. The Thirteen Finance commission has used the criteria of fiscal capacity distance for horizontal equity replacing the above mentioned criteria. Cost variations are brought into considerations through the criteria based on population, area and index of infrastructure: larger the area (per crore populations), higher the per-capita cost; similarly, lower the index of infrastructure, higher is the per-capita cost. In the case of area, which is introduced by the Tenth Finance Commission, a 'censored' distribution of area is used where a floor and ceilings are prescribed. The Fourteenth Finance Commission of India also has brought a structure of incentives through the criteria such as tax effort and fiscal discipline. If the tax effort and fiscal discipline of a state is considered to be higher than the other states, the particular state is likely to benefit more from the Finance Commissions' devolution of funds. The Tenth Finance Commission has put a weightage of 5 percent to tax effort. The Eleventh Finance Commission utilized both the index of

fiscal discipline and tax effort by assigning a weightage of 5 and 7.5 percent respectively. The Twelfth Finance Commission has assigned an equal weight of 7.5 percent to tax effort and fiscal discipline. The Thirteen Finance Commission of India has used the criteria of Fiscal Discipline by assigning a weight of 17.5 percent.

In view of the economic backwardness of Nagaland, factors such as poverty ratio, index of infrastructure, fiscal capacity distance could have helped the state to gain more transfers from the centre. However, the recent Finance Commissions of India have given more importance on efficiency factors such as tax effort and fiscal discipline along with the cost-disability factors. As such it is necessary for the state to increase the tax effort and maintain fiscal discipline. The state needs to put more revenue effort and maintain fiscal discipline to gain more revenue from the central government. Under these circumstances, it is necessary to examine the share of the state government of the total Finance Commissions' transfers. Here, percentage share of the state government under each Finance Commission is compared with the mean share of the state considering the all the twelve Finance Commissions.

The mean share of the state is found to be 1.23 percent of the total central transfer to the state through all the Finance Commissions (average of 11 Finance Commissions) till Twelfth (TFC, 2009). Deviation from the mean share is computed by deducting the mean share from the state's share under each Finance Commission. The share of the Government of Nagaland in total transfers (tax devolution + grants) as recommended by different finance commissions and its deviation from the mean share has been given in table 2.6.

Table 2.6
Deviation of Nagaland's Share of Finance Commission Transfers from the Mean Share

Finance Commission	Period for which recommendation was accommodated	Nagaland Share	Deviation from the Mean Share
III FC	1991-1996	0.05	(-1.14)
IV FC	1996-1971	2.01	(-0.81)
V FC	1969-1974	1.53	(-0.34)

VI FC	1974-1979	1.41	(-0.21)
VII FC	197919-84	1.15	(-0.04)
VIII FC	1984-1989	1.34	(-0.14)
IX FC 1	1989-1990	1.25	(-0.06)
IX FC 2	1991-1995	1.17	(-0.02)
X FC	1995-2000	1.23	(-0.04)
XI FC	2000-2005	1.02	(-0.17)
XII FC	2005-2010	0.99	(-0.21)
Median		**1.23**	

Source: Thirteen Finance Commission Report

Table 2.6 reveals that during the whole period of Finance Commission (1991-2010), deviation of the state's share from the mean share has been found to be negative. During the period of Twelfth Finance Commission, covering the period 2005-06 to 2009-10, the share of the state was found to be more than the mean share of the state. In other words, the state experienced a positive deviation from the mean share during all periods implying that share of the state under the Finance Commissions is higher. Although population and income distance are some of the factors which determine the Finance Commission transfers to the state, however, this may not be significant for reduction of the state's share compared to state's mean share during the period of study. As population of 1971 has been considered for devolution of Finance Commission funds to the states, this factor is not responsible for negative deviation of the state's share from mean share. Similarly, as divergence between the per-capita income of the state and average income of the other states has been found to be widening during the period of study, income distance criteria cannot be considered as a factor for this reduction. In other words, it is difficult to determine the exact reason for this negative deviation during the period of study.

As discussed in the previous sections, transfer to states through Finance Commission includes both shared taxes and grants-in-aid. Grants-in-aid are important components of Finance Commission transfers in India. Grants-in aid has been a matter of debate among the states since its inception. States have aired conflicting views on the

principles that govern the grants-in-aid to the revenues of the states. The amount and percentage of shared taxes and grant-in-aid as provided by the recent Finance Commissions to the state has been provided in table 2.7.

Table 2.7
Finance Commission Total Transfers to Nagaland

(Rs. in Crores)

Finance Commission	Year	Taxes & Duties Sharing	Grants-in-aid	Total Transfer
IV FC	1996-1971	23.11 (39.53)	35.35 (60.47)	58.46
V FC	1969-1974	3.66 (4.48)	77.95 (95.52)	81.61
VI FC	1974-1979	6.83 (5.03)	128.84 (94.97)	135.67
VII FC	197919-84	17.91 (7.44)	222.68 (92.56)	240.59
VIII FC	1984-1989	325.47 (61.71)	201.95 (38.29)	527.42
IX FC	1989-1995	855.26 (60.42)	560.20 (39.58)	1415.46
X FC	1995-2000	2197.38 (78.67)	595.66 (21.33)	2793.04
XI FC	2000-2005	827.90 (18.61)	3621.86 (81.39)	4449.76
XII FC	2005-2010	1613.67 (61.65)	5839.74 (38.35)	7453.41
XIII FC	2010-2015	4552.90 (33.65)	9191.30 (66.35))	13744.20
XIV FC	2015-2020	18476.00 (49.65)	18737.10 (50.35)	37213.10
XV FC	2020-2026	24039.00 (50.28)	23773.00 (49.72)	47812.00
TOTAL		**52939.09 (45.67)**	**62985.63 (54.33)**	**115924.72**

Source: Finance Commission Reports (various reports)

Table 2.7 reveals that compared to grants-in-aid, tax sharing constitutes a lesser proportion of Finance Commission transfers to Nagaland. It constituted 18.61 percent of the total Finance Commission transfer under the period of Eleventh Finance Commission (FC-XI). On an average, it constituted 35.88 percent of the total Finance Commission transfers during the period under consideration. The reduced share of Non Plan Revenue Deficit (NPRD) grant received by the state is found to be the main factor for declining share of grants-in-aid compared to shared tax. As recommended by FC-IX, NPRD grants recommended by the FC-XII was 39.86 per cent of the total grants. FC-XIII recommendations for NPRD grants amounts to 16.26 per cent of the total grants, the lowest ever in FC recommendations. It has been found that during the period of the Thirteenth Finance Commission, the state received NPRD grants of only Rs. 8146 crores for the year 2010-11 to 2014-15.

2.2.2 Transfers through Planning Commission:

The Planning Commission of India, before it was replaced by **NITI Aayog** in 2015, provided various types of grants to states to support development and fiscal stability. These grants were broadly categorized as below;

2.2.3 Plan Grants: These were central assistance grants for state plans, including.

- Normal Central Assistance (NCA): Given to states for their annual plans.
- Additional Central Assistance (ACA): Provided for specific schemes like Accelerated Irrigation Benefit Programme (AIBP) and Jawaharlal Nehru National Urban Renewal Mission (JNNURM).
- **Special Plan Assistance (SPA)**: Given to states for special projects.

2.2.4 Special Category State Grants: States classified as Special Category (like those in the Northeast) received 90% grants and 10% loans for central assistance, unlike general category states which received 30% grants and 70% loans**.**

The assistance given by the Planning Commission comprises both grants and loans. However, after the recommendation of the Twelfth Finance Commission, the assistance is confined to grants and the central government fresh loans given to states for plan purposes have been discontinued since 2005-06. Planning Commission gives assistance for implementing various plans and projects in the states. In earlier years, both the volume and composition of plan transfers were project based, but since 1969, the assistance had been allocated based on a National Development Council formula, popularly known as Gadgil formula[1]. A notable feature of Planning Commission transfer is that 30 percent of the total transfer is kept aside for distribution among the special category states on the basis of plan project formulated by them. Out of these 30 percent funds, 90 percent of the assistance is given by way of grants and the remainder as loans. The year wise grants provided by the Planning Commission for the state plan schemes have been given in table 2.8.

Table 2.8
Grants for State Plan Scheme during 2000-01 to 2019-20

(Rs. in Crore)

Year	2000-01	2001-02	2002-03	2003-04	2004-05
Grants	384.55	988.28	400.38	515.44	554.16

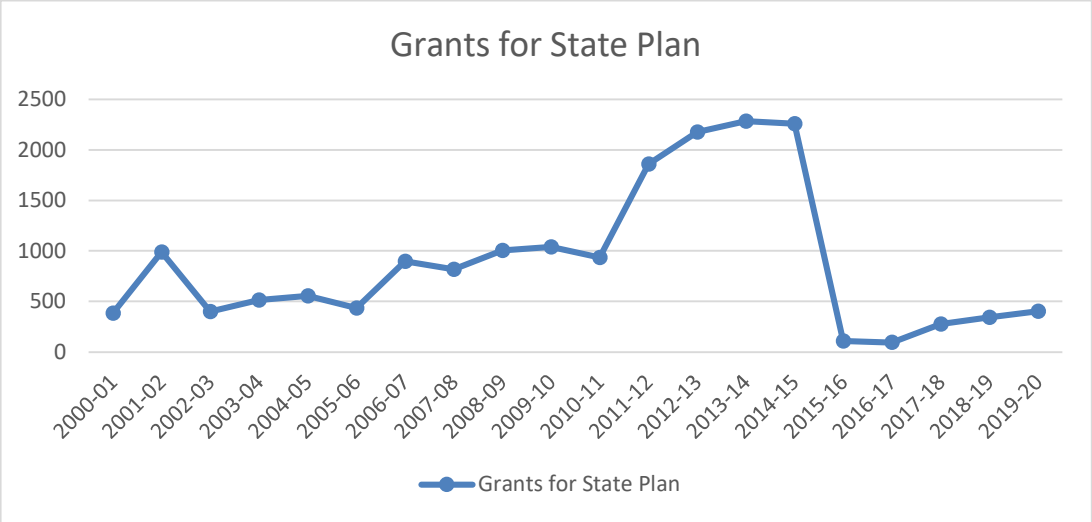
Year	2005-06	2006-07	2007-08	2008-09	2009-10
Grants	436.13	896.86	818.62	1003.27	1041

Year	2010-11	2011-12	2012-13	2013-14	2014-15
Grants	936.32	1858.21	2174.93	2283.84	2257.17

Year	2015-16	2016-17	2017-18	2018-19	2019-20
Grants	107.43	94.73	276.63	341.98	401.81

Source: State Finances Report of the C&AG of India

Figure 2.3



It is evident from table 2.8 and figure 2.3 that grants from Planning Commission constitute a significant proportion of the grants-in-aid to the state during the period under study. Nagaland was declared as a special category state in 1969 which resulted in drastic change in the grant to loan composition of plan assistance from previous 30: 70 to 90: 10. As a result, share of grants for the state plans jumped from 384.55 crore (35.85 percent) of total grants in the year 2000-01 to 2283.84 (46.17 percent) in the 2013-14. In other words, declaration of the state as a special category state in 1969 actually helped the state to receive more grants from the Planning Commission in the subsequent years.

2.2.5 Grants for Central Sector, Centrally Sponsored and Special Plan Schemes

This component of transfers is given for specified purposes with and without matching requirements. Grants for Central sector schemes are given to the states to execute central projects and are entirely funded by it. Centrally Sponsored schemes, on the other hand, are shared cost Programmes falling within the States' ambit with the uniform matching ratio across the states, varying with the projects. The schemes have attracted sharpest criticism in recent years due to their discretionary nature and conditionality attached to them (Chowdhury and Das Gupta, 2012). Additionally, there

is a provision of special plan scheme for the development of Northeastern states. The amount and percentage share of above-mentioned grants-in-aid provided by the central government to the state has been provided in Table 2.9.

Table 2.9 reveals that these three components of transfers together, on average, have constituted 17.62 percent of the total grants-in-aid during the study period. Among these three components, share of centrally sponsored scheme is found to be dominant as it constitutes, on average, 14.59 percent of the total transfers through the above schemes during the period of study. As a North-east state, Nagaland gets additional share of the grants provided for implementation of the infrastructure projects of the region under the aegis of North Eastern Council (NEC). It constituted on an average, 1.66 percent of the total grants in the year. The percentage of grants from NEC ranged from 2.63 to 0.55 percent of the total grants in the years 2012-13 and 2019-20 respectively.

During 2008-09 and 2009-10, all plan scheme grants for Nagaland were combined to streamline funding and improve efficiency in implementation. This consolidation was primarily driven by the National Rural Health Mission (NRHM), which aimed to integrate various health-related schemes under a unified framework for better resource allocation and monitoring (NRHM Report 2008[2]).

Table 2.9
Grants-in Aid for Central Plan Scheme, Centrally Sponsored Scheme and Special Plan Scheme

(Rs. in Cores)

Year	Grants for Central Plan Scheme	Grants for Centrally Sponsored Scheme	Grants for Special Plan Scheme (NEC)	Total Grants-in-Aid
2000-01	19.00	76.79	10.73	106.52
2001-02	21.67	78.45	16.30	116.42
2002-03	124.69	84.92	29.51	239.12
2003-04	15.05	110.99	20.85	146.89
2004-05	25.92	226.06	29.88	281.86

2005-06	49.12	173.65	28.63	251.40
2006-07	27.39	209.70	39.37	276.46
2007-08	57.71	177.56	45.48	280.75
2008-09	322.45			322.45
2009-10	477.01			477.01
2010-11	8.83	248.07	48.57	305.47
2011-12	39.98	431.73	84.55	556.26
2012-13	7.78	393.49	124.76	526.03
2013-14	26.66	445.30	119.61	591.57
2014-15	80.93	1428.26	94.64	1603.83
2015-16	18.41	1203.85	93.62	1315.88
2016-17	26.84	1660.65	105.45	1792.94
2017-18	25.92	2224.45	122.26	2372.63
2018-19	170.43	1439.73	45.03	1655.19
2019-20	106.85	1823.15	37.52	1967.52

Source: State Finances Report of the C&AG of India

The above discussed transfers which constituted a major portion of the state's total revenue are determined by the central government upon which state governments have no active control. The only thing the state governments can do is to fulfill the conditions attached to the transfers. In other words, the central transfers are exogenous in nature. But own revenue generation of the state depends on the effort of the state government to collect more revenues. The different sources of own tax and non-tax revenue of the state are discussed in the next section

2.3 TOTAL OWN RESOURCES OF THE STATE

Total own receipts of a state consist of both revenue receipts and capital receipts. As non-debt capital receipt comprises only a small fraction of total receipt of the state, this section concentrates mainly on the revenue receipt of the state. Other receipts of the state which includes borrowings from different sources have been included in the fourth chapter of the thesis as borrowings have repayment obligations which raise the issue of fiscal and debt sustainability. The composition and adequacy of the own revenue sources of the state tells about the fiscal autonomy and sufficiency of funds

for discharging expenditure responsibilities. Own resources of the state can be divided into two categories.

(a) Own Tax Revenue
(b) Own Non-tax Revenue

2.3.1 State's Own Tax Revenue

The following are the various sources of own tax revenue of the state government of Nagaland.

1) State Excise
2) Land Revenue
3) Stamps and Registration
4) Receipts on Motor Vehicle Taxation Act
5) Taxes on Goods and Passengers
6) Sales Tax/VAT
7) Taxes and Duties on Electricity
8) Professional Tax
9) Other Taxes and Duties

The amount and percentage contribution of different sources of tax revenue towards total own tax revenue of the state has been discussed below. Table 2.10 shows the percentage contribution of different taxes to the Total State Taxes to During 2000-01 to 2019-20. Sales tax has contributed the major portion of the state's own tax revenue during the period under consideration. On the other hand, taxes such as land revenue and Taxes and Duties on Electricity have lost their significance, and their contribution has declined during the time period 2000-01 to 2019-20. It is necessary to explore the reasons for change in contribution of the different taxes towards state tax revenue in Nagaland. A detailed discussion on each source of the state's own tax revenue has been provided in the next sub-sections.

Table 2.10

Percentage of Contribution of Different Taxes to Total State Taxes to During 2000-01 to 2019-20

Year	Total State Taxes (Rs. in Lakhs)	State Excise	Land Revenue	Stamps and Registration	Motor Vehicle Tax	Taxes on Goods and Passengers	Sales Tax/ VAT	Taxes and Duties on Electricity	Professional Tax	Other Taxes and Duties	SGST
2000-01	**5,621.00**	4.45	0.46	7.63	8.90	0.36	63.51	0.00	14.23	0.46	0.00
2001-02	**5,244.00**	3.43	0.72	3.43	10.20	0.76	57.99	0.00	22.88	0.57	0.00
2002-03	**6,189.00**	3.20	0.66	0.92	7.66	1.31	66.51	0.02	19.57	0.16	0.00
2003-04	**7,460.00**	2.82	0.40	0.80	8.04	0.67	71.05	0.00	16.09	0.13	0.00
2004-05	**7,832.00**	2.64	0.55	0.93	9.32	1.40	67.77	0.01	17.33	0.04	0.00
2005-06	**10,552.00**	1.86	0.52	0.84	8.26	1.28	73.12	0.01	14.09	0.00	0.00
2006-07	**11,903.00**	1.79	0.42	0.88	10.30	1.42	71.43	0.02	13.74	0.00	0.00
2007-08	**13,137.00**	2.15	0.38	0.78	9.36	1.67	72.15	0.02	13.49	0.00	0.00
2008-09	**15,602.00**	2.14	0.38	0.65	9.06	1.50	73.52	0.02	12.73	0.00	0.00
2009-10	**18,051.00**	1.74	0.35	0.66	9.27	2.19	73.25	0.06	12.49	0.00	0.00
2010-11	**22,732.00**	1.32	0.26	0.59	10.52	2.91	73.56	0.02	10.81	0.00	0.00
2011-12	**30,388.00**	1.11	0.22	0.61	11.38	1.60	76.06	0.01	8.89	0.13	0.00
2012-13	**33,995.00**	1.10	0.21	0.46	12.23	1.97	75.66	0.01	8.01	0.34	0.00
2013-14	**33,339.00**	1.46	0.21	0.53	10.84	3.24	75.05	0.01	8.49	0.17	0.00
2014-15	**38,861.00**	1.21	0.19	0.50	11.96	2.50	75.73	0.01	7.19	0.71	0.00
2015-16	**42,710.00**	1.20	0.18	0.48	12.43	1.38	76.93	0.01	6.94	0.45	0.00
2016-17	**51,076.00**	0.91	0.16	0.40	11.24	2.89	78.34	0.01	5.93	0.13	0.00
2017-18	**97,692.50**	0.43	0.09	0.27	10.39	1.80	29.43	0.01	3.57	0.14	53.86
2018-19	**92,113.27**	0.50	0.12	0.27	13.70	2.19	20.27	0.01	3.84	0.00	59.09
2019-20	**93,719.81**	0.53	0.12	0.30	13.34	2.37	26.98	0.01	3.89	0.03	52.43

Sources: Reserve Bank of India: State Finances - A Study of Budgets of different years.

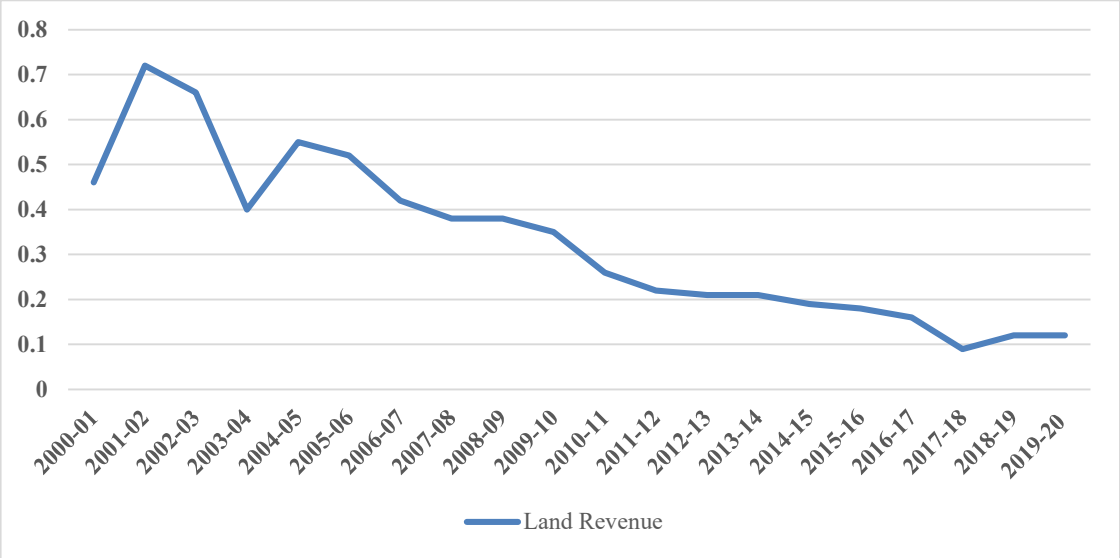
2.3.2 State Excise:

The revenue from state excise is generated from the levy of duties on Liquor sales to defence personnel through Canteen Stores Depot (CSD), Para-Military Bonded Warehouses, Fines collected from excise offenders etc. All the levies tend to be specific duties, with an effort to bring progressivity through variation in the duty depending on specific features such as alcohol content. Excise duty in the state is imposed on items like India made foreign liquor (IMFL), beer, country spirit etc. Since Nagaland enforces the Nagaland Liquor Total Prohibition Act, 1989, the excise department primarily focuses on enforcement rather than revenue generation. The average contribution of state excise found to be 1.80 percent during the period of study. The proceeds of excise duties in Nagaland have experienced periodic decrease in its share. The compound growth rate of this source of revenue is found to be 3.53 percent during the study period.

2.3.3 Land Revenue:

Land revenue in Nagaland is a relatively small component of the state's total own revenue. Based on the Nagaland Annual Financial Statement, land revenue collections have remained modest, with Rs. 110 lakh for the year 2019-20. Land Revenue Rates for urban land, tea gardens, and rural land are determined by the Nagaland Land and Revenue Regulation Act. However, these rates have remained low and largely unchanged, suggesting scope for upward revision. The percentage contribution of Land revenue towards total own revenue of the state has been provided in figure 2.4.

Figure 2.4



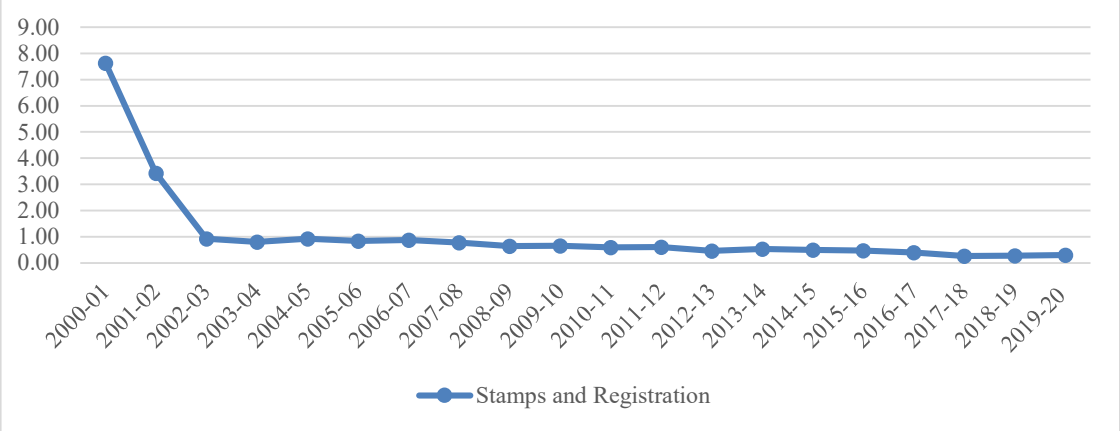
It is evident from figure 2.4 that significance of land revenue has receded for the state during the period under consideration. The increased contribution of land revenue in the years 2001-02 and 2004-05 was due to the introduction of Nagaland (Ownership and Transfer of Land and its Resources) Act, 1990. This legislation was enacted to regulate land ownership, transfer, and taxation within the state, ensuring compliance with Article 371-A of the Indian Constitution, which grants Nagaland special provisions regarding land and resources. But after that, land revenue as a tax has lost its relevance as contribution has declined particularly during the second decade of the present century. At present, proceeds from this tax have contributed only 0.12 percent of the state tax revenue in the year 2019-20. The compound growth rate of this source of revenue during the period 2000-01 to 2019-20 is found to be 7.48 *percent*, which is much less than the growth rates of other taxes.

2.3.4 Stamps and Registration

The Constitution of India segregates stamp duties and registration fees into two categories: those that are to be imposed by the union government (entry 91 of List I in

Seventh Schedule) and those that are to be imposed by the state governments (entry 63 of the list 2 of the Seventh Schedule). For the former. Union government sets the rates, while the states collect and retain the receipt. This ensures that the rates are uniform across states. For the latter, states have their own Acts and items covered may vary from state to state. While stamp duty is a tax on the value of instruments used in various business transactions, registration fees are payments made for a specific service provided by the government. The revenue from stamps and registration fees depends heavily on the value of the properties transacted. The contribution of Stamp and Registration towards total own revenue of the state has been provided in figure 2.5.

Figure 2.5



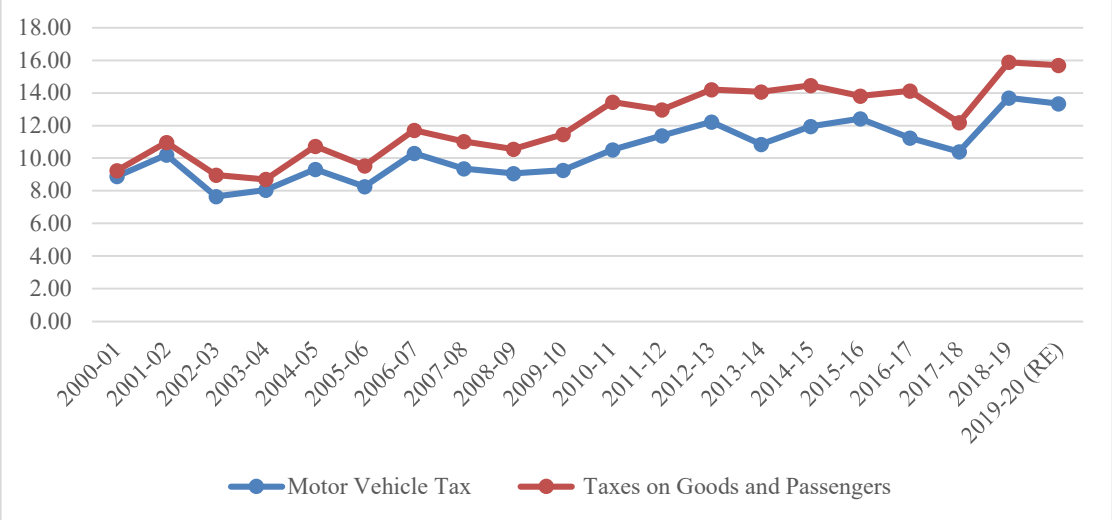
It is evident from figure 2.5 that the contribution of the stamps and registration to state tax has declined over the years from 7.63 to 0.30 percent during the period of study. In other words, it is not a significant source of state's revenue. The computed compound annual growth rate of this source of revenue is found to be -2.11 percent during the time period 2000-01 to 2019-20.

2.3.5 Transport Tax

This category of taxes includes two taxes, motor vehicles tax and tax on passengers and goods. The motor vehicle tax is imposed on the ownership of a motor vehicle and is usually described as a levy towards the use of roads in the jurisdiction. The Nagaland

Motor Vehicles Taxation Act, 1967 and Nagaland Passengers and Goods Taxation Act, 1967 are both in operation since the year of enactment and have undergone amendments over the years to update tax rates and regulations. The Motor Vehicles tax is levied on the pay load for commercial vehicles for transportation of goods, and on carrying capacity and the nature of the vehicle in the case of transportation of passengers. In the case of light vehicles, the levy is based on horsepower and weight. There is a one-time tax on personal vehicles, with rates varying by the price of the vehicles. Further, the state government introduced permit fees on different categories of commercial vehicles, excluding those of Nagaland State Transport. The permit is granted for 1 to 5 years and there are temporary permits for up to 4 months that include vehicles plying on the routes. The state has imposed passenger and goods tax in respect of passenger and goods carried by roads. The contribution of Transport taxes towards total own revenue of the state has been provided in figure 2.6.

Figure 2.6
Transport taxes as % of total State Taxes

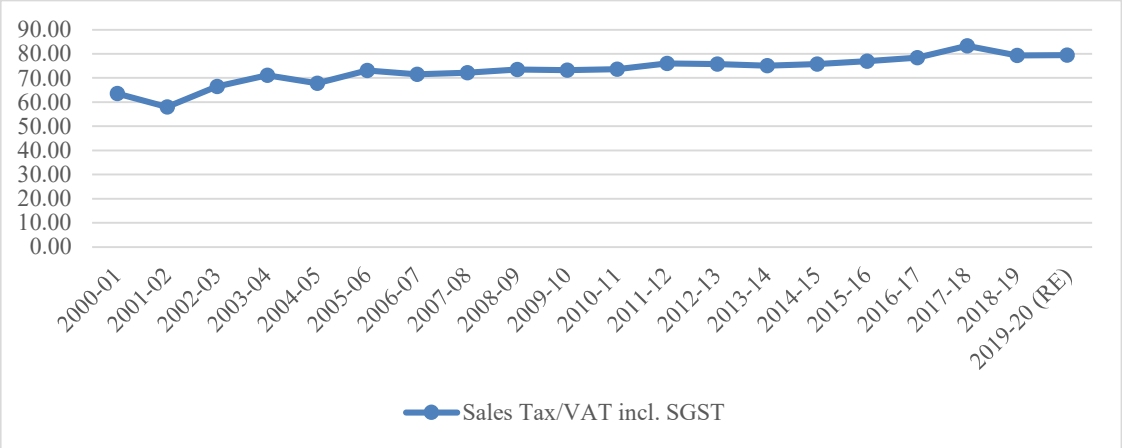


2.3.6 Sales Tax/VAT and GST

Sales tax revenue in Nagaland consists of three components, general sales tax act applicable to local sales, central sales tax applicable on inter-state sales and an entry tax applicable on selected goods imported into the state from other states in India. In addition to these taxes, the state also collects luxury tax on the sale of tobacco products and some textiles. The general sales tax is basically first point tax. Some commodities prone to evasion are taxed at two points – first point and last point. The government of Nagaland conforms to the floor rate regimes agreed upon by all the states in November 1999. Taxable commodities are categorized mainly into four rate slabs, 0, 4, 8 and 12. Regarding concessions, there are no concessions granted for the purchase of raw materials for manufacturing within the state, except as a part of the industrial incentives package, accessible to new and expanding industrial units as well as small scale units. Central sales tax is levied on interstate sales, the maximum rate being 4 percent. The state had also started levying entry tax from the year 2013. This is levied on the entry of selected goods into the state, intended for consumption or use by the importing dealer (Government of Nagaland, 2013). In order to prevent perceived inconveniences to the local dealers, the entry tax is levied if the goods brought in are not for resale, thus obviating the need for providing a set-off against taxes on subsequent sales. The goods covered include sugar and textiles, cereals and motor vehicles. The commodities that include the bulk of the sales tax revenue to the state are petroleum products, medicines, motor vehicles, coal gas, coal and coke, tinned and packet food, electronic goods, iron and steel materials, cement, edible oil etc. Of these goods, petroleum products contributed over 41.71 percent of the total sales tax collections in the state during the year 2019-20 (Government of Nagaland, 2020). The Government of Nagaland has developed a Value Added Tax (VAT) Act, 2005 which is being reviewed for ensuring conformity with the national consensus. The design of VAT is restricted to goods alone and allows for a set-off only for taxes paid within the state. In other words, it does not address the problem of taxation of inter-state trade. Value Added Tax was introduced in the State after a delay of one month i.e. May 2005, from the date of implementation of

VAT throughout the country i.e. April 2005. The contribution of sales tax towards total own revenue of the state has been provided in figure 2.7.

Figure 2.7
Percentage of Sales Tax/VAT including SGST to Total Own Revenue



It can be inferred from figure 2.7 that sales tax is the most important source of own tax revenue for the state as it contributes a major portion of the state's taxes during the study period. Average contribution of this source of revenue towards total state taxes is found to be 64.92 percent during the period under consideration. The corresponding figure for all states average is found to be 23.20 percent during the period of study (RBI, 2020). It implies that the dependence of the state on sales tax is comparatively more than the average of all states. As sales tax is the most significant source of tax revenue, it is necessary to examine the impact of the new structure of sales tax on revenue collection and volatility in the growth rate. The comparative position of pre-VAT sales tax collection (2000-01 to 2004-05) and post VAT (2005-06 to 2019-20) tax collection including VAT and growth rate in each of the years is furnished in table 2.11.

Table 2.11
A comparative position of the Pre-VAT and Post-VAT collection of Sales Tax in the State During 2000-01 to 2019-20

(Rs. in Lakh)

Year	Pre-VAT collection of Sales Tax		Post-VAT collection of Sales Tax		State Goods and Service Tax
	Actual Collection	Annual Percentage of Growth	Actual Collection	Annual Percentage of Growth	
2000-01	3,570	29.63	0	0	0
2001-02	3,041	-14.82	0	0	0
2002-03	4,116	35.35	0	0	0
2003-04	5,300	28.77	0	0	0
2004-05	5,308	0.15	0	0	0
2005-06	0	0	7,716	45.37	0
2006-07	0	0	8,502	10.19	0
2007-08	0	0	9,479	11.49	0
2008-09	0	0	11,470	21.00	0
2009-10	0	0	13,222	15.27	0
2010-11	0	0	16,722	26.47	0
2011-12	0	0	23,112	38.21	0
2012-13	0	0	25,721	11.29	0
2013-14	0	0	25,021	-2.72	0
2014-15	0	0	29,429	17.62	0
2015-16	0	0	32,858	11.65	0
2016-17	0	0	40,012	21.77	0
2017-18	0	0	28,754.5	-28.14	52,620.80
2018-19	0	0	18,668.66	-35.08	54,433.59
2019-20	0	0	25,288.81	35.46	61,322.50
Total	**21,335.00**		**3,15,975.97**		**1,68,376.89**

Sources: Reserve Bank of India: State Finances - A Study of Budgets of different years.

It is clearly evident from table 2.11 that the average growth rate of sales tax during the period 2000-01 to 2004-05 was found to be 15.82 per cent while the growth rate for the period 2005-06 to 2009-10 was 13.32 percent. Thus, the average growth rate in the post

VAT period registered a decrease of 2.5 per cent implying that implementation of VAT in the state is not as productive as expected by the government. The decline in the growth rate during the post-VAT period may suggest that VAT is not beneficial for importing states where value addition is lower relative to the exporting states. As Nagaland is a net importing state, this may imply that not much value addition has taken place in the state. Also, no improvement has been observed in the volatility of revenue collection in the post-VAT period. The state even experienced negative growth of sales tax revenue in the years 2013-14.

The Nagaland Goods and Services Tax (GST) Act, 2017 was passed by the State Legislature in May 2017 and made effective from 01 July 2017 in the State. The first year of GST implementation resulted in a high growth rate of 103.38 percent (Combined VAT & GST collection) during 2017-18. However, the same fell to a negative growth rate of -10.17 percent in the next year 2018-19. Over time, Sales Tax/VAT was fully subsumed into GST, leading to gradual improvements in tax revenue collection.

2.3.7 Taxes and Duties on Electricity

The Nagaland Electricity Regulatory Commission (NERC) oversees taxation and duties related to electricity in the state. The Electricity Act, 2003 provides the framework for levying duties on generation and consumption of electrical energy in Nagaland. Additionally, the Nagaland Electricity Regulatory Commission (Terms and Conditions for Determination of Generation Tariff for Renewable Energy) Regulations, 2011 outlines tariff structures for renewable energy sources. The legislative power of the State Legislature is, however, subject to the restriction imposed by Articles 287 and 288 of the Constitution of India. The general duty rate is 5 paise per unit of electricity generated or sold subject to such concessions as are provided in Section 12 of the Act. The concessional rate of duty is applicable in respect of industrial consumption only which extends from 1 paise per unit to 3 paise per unit depending on the quantity of energy consumed. The taxes and duties on electricity is not a significant source of revenue for the state government. On an average, it contributes less than one percent of the state

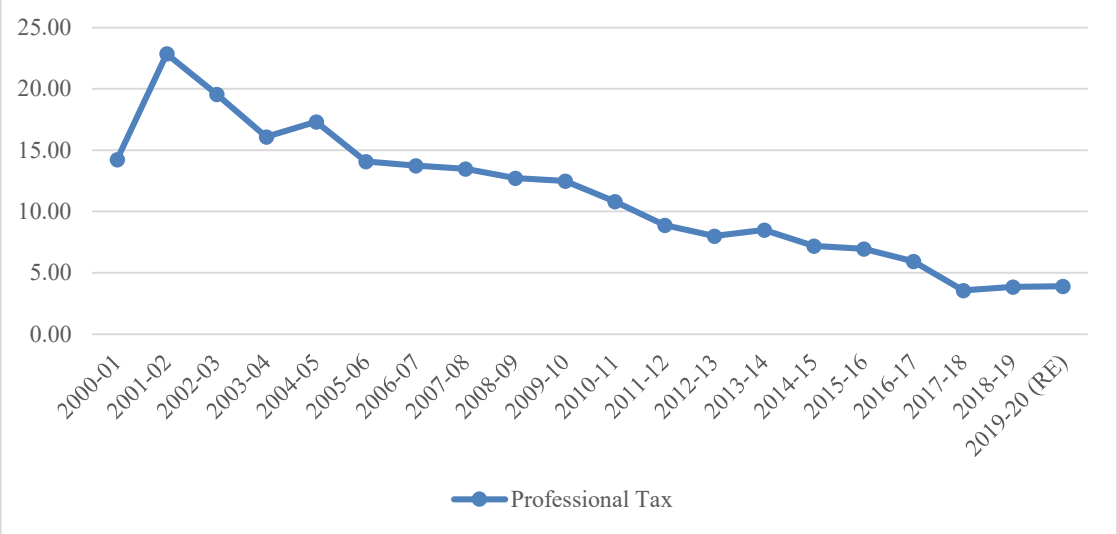
taxes during the period under study.

2.3.8 Professional Tax

The Nagaland Professions, Trades, Callings and Employments Taxation Act, 1968 was enacted to levy a tax on professions, trades, callings, and employments in the state. It applies to individuals and entities engaged in various occupations within Nagaland. Amendments have been made over the years, including changes in tax rates and exemptions. Figure 2.8 shows the share of Professional tax to state taxes during the study period.

Figure 2.8

Professional tax as % of total State Taxes



The average contribution of this source of revenue towards total state taxes is found to be 11.21 percent during the period under consideration. The same is the second highest contributor to the total state taxes after Sales Tax/VAT/GST. However, the trend of growth rate has reduced over the years from 22.88 percent in 2001-02 to 3.89 percent in 2019-20.

2.3.9 Other Taxes and Duties

The taxes which are not included in the above categories of taxes on average contribute to 0.17 percent of total state taxes during the period 2000-01 to 2019-20. These include taxes such as Amusement and betting tax, Luxury tax (Hotels and Lodging) and Nagaland Entry tax etc. The annual contribution of other taxes and duties has been found to be less than one percent during the period of study.

2.4 State's Own Non-Tax Revenue

Own non- tax revenue of Nagaland comprises of interest receipts, dividends and profits, and receipts from different general, social and economic services. The contribution of different components of non-tax revenue and their compound growth rate has been provided in table 2.12. It is evident from table 2.12 that proceeds from receipts from economic services are the major contributor of the non-tax revenue for the study period. On an average, has contributed 63.10 percent of the total non-tax revenue of the state for the period taken for analysis. Proceeds from interest receipts have gained significance during the period of study. The compound growth rate of interest receipts is found to be 5.35 per cent during the period 2000-01 to 2019-20. Significant increase in the contribution of interest receipts has been observed during the time period 2008-09 to 2009-10. The increased share of interest receipt during this period is mainly due to larger cash balance of the state government in Reserve Bank of India during that period. The contribution of other sources of non-tax revenue especially General services and Social services has been significant during the study period. The compound growth rate of General services and Social services during the study period were 12 and 15.19 percent respectively. On an average General service and Social services contributes 16.26 and 16.05 percent of State's Own Non-Tax Revenue during 2000-01 to 2019-20.

Table 2.12

Contribution of Different Sources of Non-tax Revenue Towards Total Non-tax Revenue in Nagaland

(in Rs Lakh)

Year	Interest Receipts	% to ONTR	Dividends & Profits	% to ONTR	General Services	% to ONTR	Social Services	% to ONTR	Economic Services	% to ONTR	Total
2000-01	300	6.83	0.00	0.00	671.00	15.27	599.00	13.63	2824.00	64.27	4394
2001-02	310	6.41	0.00	0.00	729.00	15.07	630.00	13.03	3167.00	65.49	4836
2002-03	100	1.97	0.00	0.00	734.00	14.48	675.00	13.32	3559.00	70.22	5068
2003-04	350	6.71	0.00	0.00	1025.00	19.64	338.00	6.48	3506.00	67.18	5219
2004-05	327	4.20	0.00	0.00	1810.00	23.23	347.00	4.45	5306.00	68.11	7790
2005-06	560	5.78	0.00	0.00	2493.00	25.75	395.00	4.08	6234.00	64.39	9682
2006-07	522	5.73	0.00	0.00	1882.00	20.65	648.00	7.11	6062.00	66.51	9114
2007-08	566	4.74	0.00	0.00	2450.00	20.51	421.00	3.52	8510.00	71.23	11948
2008-09	1157	6.41	0.00	0.00	3183.00	17.63	497.00	2.75	13218.00	73.21	18055
2009-10	1002	7.93	0.00	0.00	975.00	7.72	514.00	4.07	10143.00	80.28	12634
2010-11	1435	7.84	0.00	0.00	5089.00	27.79	1700.00	9.28	10090.00	55.09	18314
2011-12	962	4.13	0.00	0.00	6310.00	27.09	1920.00	8.24	14103.00	60.54	23295
2012-13	590	2.85	0.00	0.00	1885.00	9.10	5352.00	25.83	12890.00	62.22	20717
2013-14	762	3.52	0.00	0.00	1397.00	6.45	7686.00	35.49	11812.00	54.54	21657
2014-15	723	2.67	0.00	0.00	1961.00	7.25	11292.00	41.73	13086.00	48.36	27062
2025-16	519	2.02	494.00	1.93	1896.00	7.40	8521.00	33.24	14208.00	55.42	25638
2016-17	201	0.85	0.00	0.00	1757.00	7.45	5526.00	23.44	16094.00	68.26	23578
2017-18	697	1.79	0.00	0.00	8563.00	22.04	14335.00	36.90	15257.00	39.27	38852
2018-19	1206.11	4.73	65.82	0.26	3392.95	13.29	1871.56	7.33	18987.51	74.39	25524
2019-20	850	2.28	82.28	0.22	6468.40	17.34	10130.20	27.16	19772.52	53.01	37303
CAGR 2000-01 to 2009-10	**12.82**		**0.00**		**3.81**		**-1.52**		**13.64**		**11.14**
CAGR 2010-11 to 2019-20)	**-5.10**		**-16.41**		**2.43**		**19.54**		**6.96**		**7.37**
CAGR 2000-01 to 2019-20)	**5.35**		**-8.57**		**12.00**		**15.19**		**10.22**		**11.29**

Source: Reserve Bank of India: State Finances – A Study of Budgets.

The above analysis gives an idea about contribution and pattern of own tax and non-tax revenue of the state. The contribution of the tax and non-tax revenue of the state depends to agreat extent on the revenue effort of the government. The next section of the chapter concentrates on the revenue effort of the state government.

2.5 REVENUE EFFORT OF THE GOVERNMENT OF NAGALAND

Revenue effort may be defined as the difference between revenue potential of the state and actual collection of revenue. It is basically related to more collection of revenue through optimum utilization of tax and non-tax bases. The importance of revenue effort lies in the fact that it leads to enhancement of state's own revenue in terms of increase in collection of own tax or non-tax revenue. Apart from that, Central transfers to the state increase automatically as the tax effort and fiscal discipline are important criterion for inter-state devolution of central transfers as recommended by the recent Finance Commissions. The recent Finance Commissions of India namely Tenth, Eleventh, Twelfth, Thirteenth and Fourteenth Finance Commission have given importance to tax effort and fiscal discipline of the states by assigning due weightage as shown in table 2.5 of the previous section. The Finance Commission of India measures tax effort as the ratio of per-capita own tax revenue of a state to its per-capita income. Fiscal discipline is measured by the improvement in the ratio of own revenue receiptof the state to its total revenue expenditure, related to similar ratio of all states. As own tax revenue is the main source of total own revenue of the state, increase in tax effort is very essential for overall fiscal scenario of the state. Tax effort is a process that seeks to mobilize more revenue as the economy expands and taxable capacity increases (Oommen, 1987). It takes several forms such as introduction of new taxes, changes in the rates and basis of existing taxes, improvement in administration etc. Any measure of tax effort has to be related to taxable capacity. The need to compare tax effort was felt particularly in the context of fiscal transfers to the states under the various articles of the Constitution; particularly article 275 and 282 (Reddy, 1970). The First Finance Commission was supposed to consider tax effort as criteria while recommending grants-in-aid under article 275 but was not clearly indicated by the Commission about the operational technique that was employed by it to measure the tax effort. The Second Finance Commission too conceded the relevance of tax effort

as a consideration worth keeping in mind but avoided measuring inter-state tax effort. The Third Finance Commission did not try to measure the tax potential, on the ground that determination of inter-state tax effort had to be related to their tax potential and required special study. The Fourth Finance Commission agreed with the principles of considering how far the state had made efforts to raise resources in relation to their tax potential. It was only inthe report of Fifth Finance Commission that an attempt was made for measurement of tax effort. The Fifth Finance Commission measure of tax effort is a comprehensive measure of tax effort. But it ignores the distribution of income (wealth which back it up) which may differ from state to state. Along with that, the structure of income may differ from state to state that may affect the relative capacities (Reddy, 1975). Again, it is not clear how actually the Commissions used the results obtained in determining their award with respect to devolution of central resources among the states. The Sixth Finance Commission had come out against the use of tax effort as criteria. It was the Ninth Finance Commission that came out with a specific model for assessment of tax effort of states. The Ninth Finance Commission, in its report, employed a regression approach derived in a certain manner for making normative tax revenue projections. Although, it is not easy to find a unique method for measuring taxable capacity or the tax effort of states, different Finance Commissions and Planning Commissions adopt a simple measure of tax-GSDP ratio to evaluate tax effort and assign the required weight in the transfer design (Reddy, 1975). An inter-state comparison of tax-GSDP ratio gives an idea about the performance of the state in terms of tax effort. Keeping that fact in mind, an inter-state comparison of the tax-GSDP ratio of Nagaland with that of other states and all state averages have been made during the time period 1990-01 to 2007-08. An Improvement index has been computed as a percentage change over the previous sub-period to know the improvement of the state in a particular sub-period compared to the previous one. A and B indicate improvement in the sub-period 1995-00, 2000-05 and 2005-08 compared to the sub-period 1990-95, 1995-2000, and 2000-05 respectively. Table 2.13 as provided below gives a comparative picture of the tax-GSDP ratioof Nagaland in relation to other general and special category states for four sub-periods taken into consideration.

Table 2.13
A Comparison of Tax-GSDP Ratio of Nagaland and other States of India during 1995-2000 to 2015-2020

States	Tax-GSDP Ratio			Improvement Index	
	1995-2000	2005-2010	2015-2020	A	B
Andhra Pradesh	5.8	6.3	7.1	8.62	12.70
Bihar	4.2	4.9	5.5	16.67	12.24
Chhattisgarh	5.6	6.2	6.9	10.71	11.29
Goa	6.1	6.7	7.4	9.84	10.45
Gujarat	5.9	6.4	7	8.47	9.37
Haryana	6.3	6.9	7.6	9.52	10.14
Jharkhand	4.7	5.3	6.1	12.77	15.09
Karnataka	6.5	7.1	7.8	9.23	9.86
Kerala	6	6.6	7.3	10.00	10.61
Madhya Pradesh	5.4	6	6.7	11.11	11.67
Maharashtra	7.8	8.5	9.2	8.97	8.24
Odisha	5.7	6.3	7	10.53	11.11
Punjab	5.9	6.5	7.2	10.17	10.77
Rajasthan	5	5.6	6.2	12.00	10.71
Tamil Nadu	6.9	7.4	8.1	7.25	9.46
Telangana	6.2	6.8	7.5	9.68	10.29
Uttar Pradesh	5.3	5.9	6.6	11.32	11.86
West Bengal	5.2	5.8	6.5	11.54	12.07
Average Major States	**5.8**	**6.4**	**7.1**	**10.47**	**11.00**
Special Category States					
Arunachal Pradesh	3	3.6	4.3	20.00	19.44
Assam	4.5	5.1	5.8	13.33	13.73
Himachal Pradesh	4.8	5.4	6	12.50	11.11
Jammu & Kashmir	4.2	4.9	5.5	16.67	12.24
Manipur	3.4	4	4.7	17.65	17.50
Meghalaya	3.9	4.5	5.3	15.38	17.78
Mizoram	3.2	3.8	4.5	18.75	18.42
Nagaland	**3.5**	**4.2**	**5.1**	**20.00**	**21.43**
Sikkim	4.1	4.8	5.6	17.07	16.67
Tripura	3.7	4.3	5	16.22	16.28
Uttarakhand	4.9	5.5	6.2	12.24	12.73
Average Special Category States	**3.9**	**4.6**	**5.3**	**16.35**	**16.12**

Source: Nagaland Finance Commission Report, Open Budgets India-Dataset.

Alternative **TABLE 2.14**

A Comparison of Tax-GSDP Ratio of Nagaland and other States of India during 1990-95 to 2005-2008

States	Tax-GSDP Ratio				Improvement Index		
	1990-95	1995-00	2000-05	2005-08	A	B	C
Andhra Pradesh	4.79	6.54	7.65	8.11	-3.68	16.97	6.01
Bihar	4.32	4.11	4.89	4.67	-4.86	18.98	-4.50
Goa	7.38	7.01	7.22	8.06	-5.01	3.00	11.63
Gujarat	7.9	7.29	7.25	7.16	-7.72	-0.55	-1.24
Haryana	7.34	6.77	8.24	9,01	7.77	21.71	9.34
Karnatak	9.04	8.52	9.28	10.61	-5.75	8.92	14.33
Kerala	8.48	8.6	8.68	8.29	1.42	0.93	-4,49
Madhya Pradesh	5.19	5.53	6.75	7.60	6.55	22.06	12.59
Maharashtra	7.26	6.88	7.89	7.97	-5.23	14.68	1.01
Orissa	4.66	4.42	6.1	6.16	-5.15	38.01	0.98
Punjab	7.12	6.3	7.54	7.87	-11.52	19.68	4.38
Rajasthan	5.61	5.59	6.93	7.39	-0.36	23.97	6.64
Tamil Nadu	8.67	8.6	9.12	9.89	-0.81	6.05	8.44
Uttar Pradesh	4.97	4.9	6.04	6.78	-1.41	23.27	12.25
West Bengal	5.69	4.59	4.37	4.62	-19.33	-4.79	5.72
Major States	**6.54**	**6.35**	**7.14**	**7.62**	**-2.91**	**12.44**	**6.72**
Special Category States							
Assam	3.89	3.86	4.92	5.33	-0.77	27.46	8.33
Arunachal Pradesh	0.54	0.74	1.69	2.06	37.04	128.38	21.89
Himachal Pradesh	5.17	5.24	5.66	-	1.35	8.02	-
Jammu & Kashmir	3.66	3.70	5.60	-	1.09	51.35	-
Manipur	1.59	1.36	1.66	1.92	-14.47	22.06	15.66
Meghalaya	3.39	3.15	3.42	3.80	-7.08	8.47	11.11
Mizoram	0.69	0.70	1.18	1.88	1.45	68.57	59.32
Nagaland	1.58	1.39	1.38	1.91	-12.03	-0.72	38.41
Sikkim	3.97	5.28	7.61	5.79	33.0	44.13	-23.92
Tripura	2.12	2.19	2.72	3.08	3.30	24.20	13.24
Special Category	**3.36**	**3.43**	**4.30**	**5.23**	**2.08**	**25.36**	**21.63**

Source: Handbook of Statistics of State Government Finances, Reserve Bank of India, Various issues, Central Statistical Organization, Government of India.

It is evident from table 2.13 that the state exhibited better performance in tax-GSDP

ratio in the first decade of the present century compared to the previous decade. In fact, the state experienced deterioration in the tax-GSDP ratio in the second half of the 1990s compared to the first half. The performance of the state is found to be poor compared to the other non-special category states such as Karnataka, Kerala, Maharashtra, Tamil Nadu etc. for all the sub- period considered for the study. Although, the ratio is found to be higher than the special category states as aggregates, but it is found to be less than some special category states such as Himachal Pradesh and Sikkim etc. As tax-GSDP ratio of the state is found to be poor compared to the other developed states, it is necessary to find out the reasons behind the low tax-GSDP ratio of the state.

It is very difficult to provide a quantitative measurement of revenue potential and subsequently prescribe policy suggestion on the basis of it. The buoyancy coefficient of the state revenue particularly with respect to GSDP is a good statistical tool for measuring revenue effort of a state. Along with that, arrears of tax and non-tax revenue and cost of collection of different revenue sources provide an idea about the efficiency of the administrative machinery of the state. Cost recovery of different services is also considered as an indicator for measuring revenue effort of the government. So, revenue effort is a multi-dimensional concept which encompasses all the issues such as buoyancy, cost of collection of different sources of revenue, arrear of revenue and cost recovered from different services etc.

2.5.1 Method to calculate Improvement Index

Current year tax - to GSDP ratio/ Base year tax-to GSDP ratio x 100

Suppose in case of Nagaland 2024-25

Current year tax to GSDP ratio is 10.9% and base 10.0%

Then 10.9% / 10% x100 = 109%

This indicates 9% improvement in the tax-to-GSDP ratio which has increased compared to the base year.

The improvement index shows how much the Tax-to-GSDP ratio has increased or decreased compared to the base year.

Greater than 100 indicates that the ratio has improved (increased) while less than 100 suggests a decline

Alternatively, the formula is;

Current year- Previous Year/ Previous year x100

2.6 Buoyancy of Revenue Sources:

Two factors can give rise to growth in tax or non-tax revenues: (1) the rules or rates of tax or non-tax can be changed to raise more revenue from the same base or (2) the base on which it is imposed may grow. The growth of revenue in response to GDP or GSDP can therefore be broken down into two components: the automatic growth as the base on which the tax or non-tax is charged grows in relation to GDP, and the growth resulting from discretionary changes in rates and rules. The combined effect of the above-mentioned factors on tax or non-tax revenue is known as the buoyancy of tax or non-tax revenue of the state. The simplest method for measuring buoyancy for individual year is to calculate growth rate of the parameter divided by growth rate of GSDP.

Buoyancy = (% change in Revenue) / (% change in GSDP)

The steps to calculate or estimate **Tax Buoyancy** are.

- Collect multi-year time series data on tax collection
- Collect data on variables representing the tax base or economic activity over the same period under consideration. Examples of such variables can be GSDP, personal Income, corporate profits, consumption etc.
- Plot a regression model based on the data collected using the tax revenue as a dependent variable and the tax base as a combination of independent variables.
- The coefficient of the set of independent variables in the estimated tax buoyancy.

2.7 Regression Equation:

The model takes the following form: $\text{Log}(TR) = \alpha + \beta 1 * \text{Log}(TB) + \epsilon$, where:

TR = Tax Revenue
TB = Tax Base (or Economic Indicator like GSDP)
α = Intercept
$\beta 1$ = Buoyancy coefficient
ϵ = Error term

Table 2.15

Regression of Tax Revenue on Tax Base (GSDP)

Tax Revenue	Coefficient	Standard Error	t	P>|t|	
Tax Base (GSDP)	0.03113	0.001715	18.15	0.000	
Constant	-117.345	26.81067	-4.38	0.000	
R2	0.9482	**Source**	**ss**	**df**	**ms**
Adjusted R2	0.9453	**Model**	1271061	1	1271061
Number of		**Residual**	69465.79	18	3859.211
Observation	20	**Total**	1340527.16	19	70554.0612

*Calculated using **STATA 17***

The regression estimates the relationship between Tax Revenue (dependent variable) and **Tax Base (GSDP (independent variable) based on 20 annual observations.

Regression Equation

$Tax\ Revenue = -117.345 + 0.03113 \times GSDP$

- **Intercept ($\beta_0 = -117.345$)**

  The model's constant term implies that when GSDP is zero, the predicted tax revenue would be –117.345 (in the same monetary units). Although a negative intercept has no practical fiscal meaning, it is not unusual when the observed data do not include a zero GSDP.

- **Slope ($\beta_1 = 0.03113$)**

  For each additional unit increase in GSDP, tax revenue rises by approximately 0.03113 units. In percentage terms, a 1-unit (e.g., ₹1 billion) increase in GSDP is associated with a ₹0.03113 billion (₹31.13 million) increase in tax revenue.

Statistical Significance

Coefficient	Std. Error	t-statistic	p-value
GSDP (0.03113)	0.001715	18.15	0.000
Constant (–117.345)	26.81067	–4.38	0.000

- The **GSDP coefficient** is highly significant ($t = 18.15$, $p < 0.001$), indicating a robust, positive relationship between economic base and tax revenue.
- The **intercept** is also statistically significant ($t = –4.38$, $p < 0.001$), though its economic interpretation is limited.

Model Fit

- **$R^2 = 0.9482$**

  About 94.82% of the variation in tax revenue is explained by changes in GSDP, reflecting an excellent fit.
- **Adjusted $R^2 = 0.9453$**

  Adjusting for the single predictor yields virtually the same explanatory power, confirming no overfitting.

Analysis of Variance (ANOVA)

Source	SS	df	MS
Model	1,271,061	1	1,271,061
Residual	69,465.79	18	3,859.21
Total	1,340,527.16	19	70,554.06

- The Model Sum of Squares (1,271,061) dominates the Residual Sum of Squares (69,465.79), underscoring the model's strong explanatory capability.

Economic and Policy Implications

1. **Strong Revenue Elasticity:**

   A coefficient of 0.03113 implies that Nagaland's tax revenue base is highly responsive to economic growth. Policy measures that boost GSDP—through infrastructure investment, industrial promotion, or service-sector development—are likely to yield disproportionately large gains in tax receipts.
2. **Revenue Forecasting:**

   Budget planners can reliably forecast tax revenues based on projected GSDP, using this model as a near-deterministic guide given the high R^2.

3. **Structural Reforms:**

Since revenue growth closely tracks GSDP, enhancing the formal economy and broadening the tax net (e.g., via improved compliance, digitization) could further strengthen this relationship and raise the slope coefficient over time.

The regression of tax revenue on GSDP demonstrates a strong, statistically significant positive relationship, with over 94% of revenue variation explained by economic base changes. This underscores the critical importance of economic growth for augmenting state tax revenues and validates the use of GSDP-based forecasting in Nagaland's fiscal planning.

2.8 Year Wise Buoyancy Coefficients of Revenue

The year wise buoyancy coefficients of the own revenue, own tax revenue and own non-tax revenue of Nagaland has been provided in table 2.16.

Table 2.16

Year wise Buoyancy Coefficients of Own Revenue, Own tax, Sales tax and Own Non-tax Revenue of Nagaland

Year	Own Revenue	Own Tax Revenue	Sales Tax	Own Non-tax Revenue
2000-01	37.91	71.27	229.15	3.96
2001-02	120.76	150.44	-119.23	85.76
2002-03	52.47	87.42	239.01	8.25
2003-04	215.12	102.33	278.78	374.22
2004-05	200.39	138.12	1.45	270.51
2005-06	286.52	337.15	440.06	235.60
2006-07	42.19	139.67	111.37	-64.15
2007-08	120.55	64.63	71.54	193.65
2008-09	202.79	111.34	124.63	303.32
2009-10	-99.55	177.00	172.15	-338.44
2010-11	233.31	179.20	182.93	310.64
2011-12	172.40	188.58	213.94	152.30
2012-13	14.65	90.54	86.12	-84.44
2013-14	3.93	-14.60	-20.57	34.34
2014-15	150.08	125.08	133.08	188.44

2025-16	-128.67	-346.15	-407.34	183.57
2016-17	224.51	173.98	193.34	308.70
2017-18	156.24	195.84	-220.71	97.65
2018-19	63.95	286.05	-307.72	-300.96
2019-20	150.42	111.76	300.00	278.60

Source: C&AG Report on State Finances

2.9 Cost of collection of Revenue

The gross collection in respect of the major revenue receipts, expenditure incurred on collection and the percentage of such expenditure to gross collection during the years 2000-01, 2007-08, 2018–19 and 2019-20 along with the relevant all India average percentage of expenditure on collection to gross collection for the same years, are mentioned below:

Table 2.17
Cost of Collection by Tax Type

Year	Tax Type	Revenue Collected (₹ crore)	Cost of Collection (₹ crore)	% of Collection Cost	All India (Average)
2000–01	State Excise	1.89	3.92	207.41	~ 3.00
2007–08	State Excise	2.83	6.24	220.49	3.30
2018–19	State Excise	0.50	2.29	458.00	~ 2.90
2019–20	State Excise (Budget)	0.55	2.64	480.00	~ 2.80
2007–08	Taxes on Vehicles	12.30	2.79	22.68	2.47
2018–19	Taxes on Vehicles	12.50	2.38	19.04	-
2019–20	Taxes on Vehicles	13.17	2.64	20.04	~ 2.50
2007–08	Stamps & Registration	1.02	0.38	37.25	2.33
2018–19	Stamps & Registration	0.28	0.18	64.29	-
2019–20	Stamps & Registration	0.31	0.20	64.52	~ 2.20

Source: CAG reports and government sources

The cost of collecting State Excise has consistently exceeded the revenue it generates, peaking at nearly 480% in 2019–20. Taxes on Vehicles and Stamps & Registration also show relatively high collection costs compared to national averages. These figures suggest persistent inefficiencies in tax administration, especially for low-yield revenue heads.

2.10 Arrears of Revenue

Based on CAG audit reports from 2000-01 to 2019-20, Nagaland faced persistent arrears of revenue across several departments. Here is a department-wise breakdown highlighting key issues:

Table 2.18

Department-Wise Arrears of Revenue (Select Years)

Year	Department	Arrears (Rs. crore)	Key Issues Identified by CAG
2005–06	Power Department	100+	High default rates; poor enforcement of disconnection rules
2010–11	Motor Vehicles	5.2	Unpaid taxes from thousands of vehicles
2015–16	Finance (Taxation)	3.8	VAT evasion; delayed penalty recovery
2016–17	State Lotteries	2.0	Non-renewal of licenses; weak oversight
2018–19	Power Department	290+	Dimapur & Kohima top defaulters; arrears over 4 years
2019–20	Motor Vehicles	9.37	12,050 vehicles defaulted; no legal action taken
2019–20	Finance (Taxation)	12.49	VAT evasion by 21 dealers; penal interest not recovered
2019–20	Multiple Departments	320+	Outstanding Utilization Certificates across 16 departments

Source: CAG reports and government sources

Power Department consistently had the highest arrears, especially from domestic consumers. Motor Vehicles Department struggled with enforcement, leading to thousands of defaulters. Finance (Taxation) faced recurring issues with VAT evasion and delayed recovery. State Lotteries and other departments showed lapses in licensing and oversight.

2.11 Cost of Recovery of Social and Economic Services

According to CAG audit reports and Nagaland Economic Surveys, the cost recovery on social and economic services in Nagaland from 2000–01 to 2019–20 remained consistently low, indicating heavy reliance on government subsidies and limited user charges.

Table 2.19
Cost of Recovery of Social and Economic Services

Year	Sector	Revenue Realized (₹ crore)	Expenditure Incurred (₹ crore)	Cost Recovery (%)
Social Services				
2000–01	Education	0.80	250.00	0.32%
2005–06	Health	1.20	120.00	1.00%
2010–11	Water Supply	3.50	85.00	4.12%
2015–16	Urban Development	2.10	60.00	3.50%
2019–20	Education	1.25	600.00	0.21%
2019–20	Health	2.00	250.00	0.80%
Economic Services				
2000–01	Agriculture	0.50	100.00	0.50%
2005–06	Transport	5.00	80.00	6.25%
2010–11	Power	50.00	120.00	41.67%
2015–16	Industries	1.00	40.00	2.50%
2019–20	Power	149.77	300.00	49.92%
2019–20	**Irrigation**	**0.12**	**35.00**	**0.34%**

Source: CAG reports and government sources

Social services like education and health consistently recovered less than 1% of their costs. Economic services, especially power, showed better recovery but still fell short of full cost coverage. The CAG recommended rationalising user charges, improving billing systems, and enhancing service delivery efficiency to reduce fiscal stress.

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1. The Gadgil formula was formulated during the Fourth Five Year Plan for distribution of plan transfers amongst the states. It was named after the then Deputy Chairman of the Planning Commission, Dr. D R Gadgil.

2. State Programme Implementation Plan 2008-09, National Rural Health Mission, Government of Nagaland, March 2008.

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CHAPTER - 3

PATTERN OF PUBLIC EXPENDITURE AND EXPENDITURE IMPLICATIONS OF FISCAL REFORM MEASURES

In the previous chapter, the nature and pattern of revenue scenario of the state is analyzed for examining the availability of funds for expenditure needs of the state. Improvements have been noticed in the revenue scenario of the state during the first decade of the present century compared to the previous decade. The improved revenue scenario of state government is found to be mainly due to increase in own revenue collection and higher allocation from the central government. The fiscal reform measures adopted during the time period are found to be one of the main reasons which has helped the state government to receive more funds from the central government as well as to increase the state's own revenue collection. As fiscal reforms encompass both the aspects of revenue and expenditure, it is necessary to examine the impact and implication of those expenditure reform measures on pattern and quality of government expenditure. At the same time, it is also pertinent to study whether improvements in the revenue scenario of the state are sufficient to discharge the expenditure responsibilities of the state.

Availability of funds or lack of it for different expenditure obligations actually determines the economic growth and development of a state. Available literature on public expenditure states that there is a close relationship between growth of GSDP and growth of public expenditure (Wagner, 1983; Peacock and Wiseman, 1961; Musgrave, 1969). Mention may be made of Wagner's hypothesis which states that an increase in GSDP leads to more than proportionate increase in public expenditure. In other words, higher public expenditure is a result of economic growth. In Federal forms of government, states as sub-national level entities have a vital role in economic development of a country. State governments in India have to incur different kinds of expenditure either for the satisfaction of the collective needs of the citizens or for promoting their economic and social welfare. The minimal function of the state governments in India is to address the problem of market failure and to improve equity among the people (Gupta, 2001; Dholakia and Dholakia, 2004). Governments have to undertake those activities where market cannot provide maximal outcome such as providing pure public goods, maintaining law and order and property rights, providing public healthcare facilities and macroeconomic management etc. It is also necessary to improve equity among the people through such activities such as anti-poverty measures, disaster relief and public distribution

etc. (World Bank, 2005; Government of India, 2002). As public investment is the main instrument of economic development in India, it is necessary to analyse the specific expenditure responsibilities of each tier of government.

3.1 Expenditure Responsibilities of the States and Central Government in India

The Constitution of India has assigned specific expenditure responsibilities to each tier of the Government under separate list. The Seventh Schedule (Article 246) of the Constitution lays down the respective financial resources of the Union and State governments in India. It has been found that most of the developmental and normal administrative functions such as public order, police, local government, public health and sanitation, hospitals and dispensaries, agriculture, water, fisheries, public debt etc. are assigned to the states, which increase their expenditure obligations relative to the Union Government (Heller and Rao, 2006). The responsibility of the central government is to provide the national public goods such as defence, atomic energy and mineral resources, foreign affairs, diplomatic relations, railways, airways, posts and telegraph, and currency and coinage etc. In other words, state governments in India have to play a significant role in a number of areas critical for enhancing growth and development of the state. They have the responsibility of both maintaining law and order and providing most of the economic and social infrastructure. They are closer to the people and have direct interface with them which makes them prone to comments on governance, quality of expenditure, applications of resources and performance of the services provided (Lahiri, 2000; Shariff et al. 2002). As a result, proper allocation and prioritisation of the expenditure of the state governments have been an issue of discussion in recent times. This is more significant in a state like Nagaland where public investment plays a significant role in economic development. Due to its difficult geographical terrain and poor infrastructure, private sectors are not willing to invest in the state. State government, through its investment in social and physical infrastructure, has to remove those bottlenecks that hinder the development of the state. At the same time, state government has to judiciously use its limited resources to maintain fiscal stability. The growth of public expenditure on priority sectors is expected to lead the state into the path of economic development. Under these circumstances, it is necessary to analyse the trend and pattern of public expenditure of the state during the period under consideration.

3.2 Trend and Pattern of Total Expenditure of the State

Total expenditure of the state includes revenue expenditure, capital outlay and loans and advances provided by the state government for different activities. The trend and buoyancy of the total expenditure during the study period provides vital information about the growth of total expenditure with respect to overall growth of the economy. The ratio of total expenditure to GSDP has been computed to observe the relative growth of expenditure with respect to GSDP of the state. As done in the previous chapter, decade wise compound growth rate has been computed to have an idea about the relative growth of total expenditure in the two decades. The growth and buoyancy of total expenditure and ratio of total expenditure with respect to GSDP of the state during the study period has been provided in table 3.1.

Table 3.1
Pattern of Growth and Buoyancy of Total Expenditure of the State during 2000-2001 to 2019-10

(Rs. in crore)

Year	Total Expenditure	Annual Growth of Total Expenditure	Gross State Domestic Product (GSDP)	Growth rate of GSDP %	Total Expenditure as Percentage of GSDP	Buoyancy of Total Expenditure with GSDP
2000-01	1531.98	15.16	3679.36	23.98	41.64	0.34
2001-02	1669.27	8.96	4136.88	12.43	40.35	0.72
2002-03	1849.29	10.78	4748.60	14.79	38.94	0.73
2003-04	2209.20	19.46	5238.66	10.32	42.17	1.89
2004-05	2064.41	(-) 6.55	5778.77	10.31	35.72	(-) 0.636
2005-06	2579.01	24.93	6374.56	10.31	40.46	2.42
2006-07	2932.87	13.72	6957.97	9.15	42.15	1.50
2007-08	3395.38	15.80	8075.27	11.27	42.05	1.40
2008-09	3742.99	10.24	9436.07	16.85	39.67	0.61
2009-10	4244.24	13.39	10272.88	8.87	41.31	1.51
2010-11	5313.37	25.19	11759.00	11.70	45.19	2.15
2011-12	6126.04	15.29	13859.00	17.86	44.20	0.86
2012-13	6856.77	11.93	15676.00	13.11	43.74	0.91
2013-14	6956.09	1.45	17749.00	13.22	39.19	0.11
2014-15	7783.50	11.89	20099.00	13.24	38.73	1.10
2015-16	8638.56	10.98	19524.00	6.10	44.25	1.80
2016-17	9725.74	12.58	21722.45	11.26	44.77	1.12
2017-18	11466.39	17.89	24491.70	12.75	46.82	1.52
2018-19	12520.81	9.19	27283.04	11.40	45.89	0.95

2019-20	12852.60	2.65	30507.83	11.82	42.13	0.62

CAGR of Expenditure for the years 2000-01 to 2009-10: **10.73**
CAGR of Expenditure for the years 2010-11 to 2019-20: **9.24**
CAGR of Expenditure for the years 2000-01 to 2019-20: **11.22**

Source: State Finances, Audit Report of the Comptroller and Auditor General of India (C&AG)

Note:

Basis of calculation:

1. *Buoyancy of a parameter = Rate of Growth of the parameter/GSDP Growth*
2. *Buoyancy of a parameter (X) with respect to another parameter (Y) = Rate of Growth of parameter (X)/ Rate of Growth of parameter (Y)*
3. *Rate of Growth (ROG) = [(Current year Amount/Previous year Amount)-1] * 100*

Buoyancy ratio:

Buoyancy ratio indicates the elasticity or degree of responsiveness of a fiscal variable with respect to a given change in the base variable. For instance, revenue buoyancy at 0.7 implies that revenue receipts tend to increase by 0.7 percentage points, if the GSDP increases by one per cent.

Compound Annual Growth Rate (CAGR):

The Compound Annual Growth Rate is calculated by taking the n^{th} root of the total percentage growth rate, where n is the number of years in the period being considered.

CAGR = [ending value /beginning value]$^{1/no\ of\ years}$ -1

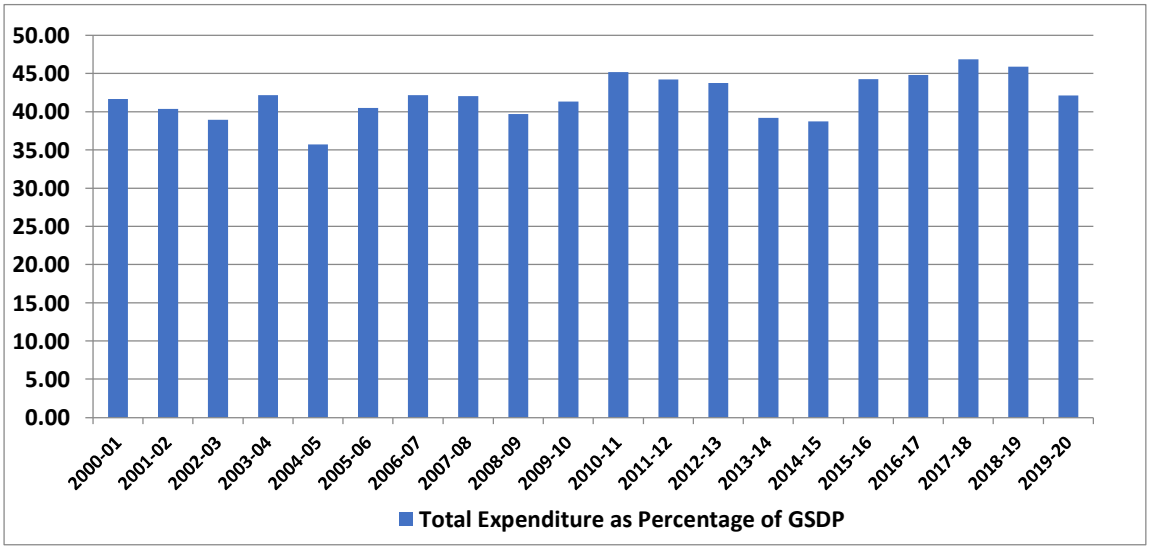
It is clear from table 3.1 that total expenditure of the state government has increased from Rs. 1531.98 crore in 2000-01 to Rs. 4244.24 crore in the year 2009-10 and registering a compound annual growth rate of 10.73 percent during that period. Similarly, the aggregate expenditure of the government has increased from Rs. 5313.37 crores in 2010-11 to Rs. 12852.60 crores in 2019-20 and thus registering a growth rate of 9.24 percent during that period. The average ratio of aggregate expenditure to GSDP of the state during the study period is found to be lower. The growth rate of total expenditure of the state in the second sub-period (2010-11 to 2019-2020) is found to be lower than the growth rate of total expenditure in the first sub-period under consideration. While the average annual growth rate of total expenditure in 2010-11 to 2019-20 was 11.90 percent, the same was found to be 14.72 percent in the previous sub-period. Additionally, a wide fluctuation has been noticed in the annual growth rate of total expenditure during the study period. High and unusual increase in total expenditure of the state has been noticed in some years such as 2005-06 and 2010-11. The significant increase in total expenditure in 2010-11 was mainly due to implementation of the revised pay scale to the government employees. The significant increase in total expenditure in 2017-18 was due to increase in non-plan revenue expenditure by Rs. 10188.59

crore and capital expenditure under economic services by Rs. 1274.85 crore which were nearly 88.88 percent and 11.12 percent respectively of the total expenditure. (Government of Nagaland, State Finances Audit Report of the C&AG, ended 31st March 2018). The state also experienced negative growth in total expenditure in the year 2004-05. Decline in revenue expenditure on economic services and grants-in-aid as well as decline in capital expenditure on general services contributed towards negative growth of total expenditure in the year 2004-05. The negative growth of total expenditure in the year 2004-05 was mainly due to decrease in economic services and less disbursement of loans over the previous year. The expenditure in 2004-05 decreased substantially by 6.55 *per cent* compared to the previous year.

It is necessary to unearth the reasons for these fluctuations in total expenditure of the state. The classification of the total expenditure into different components provides the reasons for such wide fluctuation in total expenditure which is carried out in the next sub-sections. The average ratio of total expenditure to GSDP of the state during the period of study is found to be 41.97 percent. The total expenditure-GSDP ratio of the state was found to be more or less stable during 2000s, which ranged from 35.72 percent in 2004-05 to 42.17 percent in 2003-04. After that, the ratio was found to increase and attained a high of 45.19 percent in 2010-11 which was followed by decline in the subsequent years. A sudden increase in the ratio was observed in the year 2015-16 as total expenditure-GSDP ratio of the state jumped from 38.73 percent in 2014-15 to 44.25 percent in 2015-16. As discussed above, this was due to payment of revised pay scale to the government employees which led to sudden increase in total expenditure. During the second decade of the present century, the average ratio of total expenditure – GSDP of the state was found to be comparatively higher than the previous decade. The year wise buoyancy of total expenditure of the state has been found to be positive and more than one for most of the years implying that there was a significant increase in total expenditure with respect to growth of GSDP during the study period. The total expenditure-GSDP ratio of the state during the period of study has been provided in figure 3.1.

Figure 3.1

Ratio of Total Expenditure to GSDP of the State during the Study Period



It is evident from figure 3.1 that, during 2010, the ratio was within the range of 35.72 percent in 2004-05 to 42.17 percent in 2003-04. Increase in the ratio was noticed during the time period 2015-16 to 2019-20, particularly in the year 2017-18 and 2018-19. As increase in total expenditure has been observed during the period of study, it is necessary to unearth the reasons for such increase in expenditure during the period under study. The pattern of public expenditure over the years gives detailed information regarding nature and composition as well as reasons for increase in expenditure of the state.

3.3 Pattern of Total Expenditure in Nagaland:

The pattern of expenditure basically implies the allocation of expenditure under different heads such as revenue expenditure, capital outlay and disbursement of loans and advances etc. Capital outlay represents net of capital expenditure after repayment of public debt (RBI, 2007). Capital outlay is that part of capital expenditure which is actually spent for creation of assets. The composition of total expenditure in Nagaland in terms of revenue expenditure, capital outlay and disbursement of loans and advances has been provided in table 3.2.

It is quite evident from table 3.2 that revenue expenditure constitutes the major portion of the total expenditure of the state during the period of study ranging from 75.74 percent in the year 2007-08 to 90.54 percent in the year 2019-20. On average, revenue expenditure has constituted 82.65 percent of the total expenditure of the state during the period under study.

Compared to that, revenue expenditure of all states has constituted, on an average, 84.55 percent of the total expenditure for the above-mentioned period (RBI, 2011). The higher proportion of revenue expenditure to total expenditure of the state compared to all states average implies that fewer resources are available for other productive uses such as capital outlay and advancement of loans and advances. This may hamper the overall economic development of the state. Similarly, capital outlay is found to constitute, on an average, 17.24 percent of the total expenditure of the state compared to all states average of 11.52 percent during the period of study. The average expenditure on loans and advances is found to constitute 0.11 percent of the total expenditure of the state compared to all states average of 14.65 percent during the period taken for the analysis (RBI, 2012). The low average expenditure of the state on loans and advances indicates that fewer resources are available for meeting those expenditures.

Table 3.2

Composition of Total Expenditure of Government of Nagaland during 2000-01 to 2010-20 ***(Rs. in crore)***

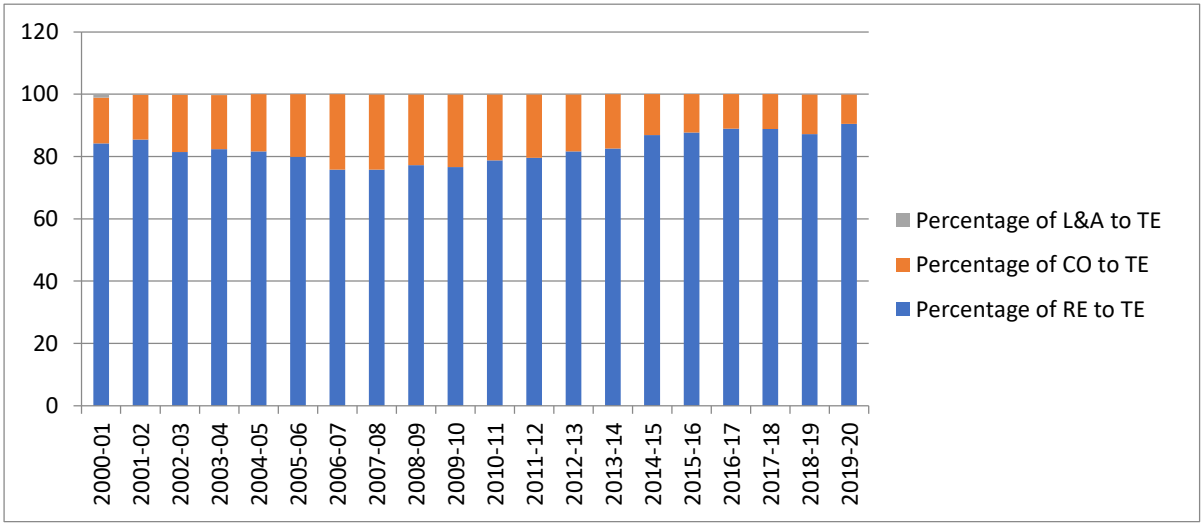
Year	Revenue Expenditure	Capital Outlay	Disbursement of Loan	Total Expenditure	Percentage of RE to TE
2000-01	1290.23	224.40	17.35	1531.98	84.22
2001-02	1427.11	238.73	3.43	1669.27	85.49
2002-03	1506.27	340.69	2.33	1849.29	81.45
2003-04	1839.52	391.13	5.08	2235.73	82.28
2004-05	1684.63	379.44	0.34	2064.41	81.60
2005-06	2060.53	517.87	0.61	2579.01	79.90
2006-07	2222.15	710.48	0.24	2932.87	75.77
2007-08	2572.27	821.48	2.61	3396.36	75.74
2008-09	2889.54	853.09	1.46	3744.09	77.18
2009-10	3252.44	989.53	3.55	4245.52	76.61
2010-11	4187.84	1122.94	4.12	5314.9	78.79
2011-12	4875.66	1249.39	2.75	6127.8	79.57
2012-13	5601.39	1255.18	2.16	6858.73	81.67
2013-14	5750.34	1207.06	0.92	6958.32	82.64
2014-15	6762.41	1023.17	0.19	7785.77	86.86
2015-16	7581.92	1059.23	0.19	8641.34	87.74
2016-17	8651.94	1076.10	0.19	9728.23	88.94
2017-18	10191.35	1274.85	0.19	11466.39	88.88
2018-19	10919.98	1595.56	5.27	12520.81	87.21
2019-20	11,637.02	1,206.32	9.26	12852.6	90.54

Source: State Finances Audit Report of the Comptroller and Auditor General of India (C&AG)

During 2000, ratio of revenue expenditure to total expenditure of the state was found to be comparatively low in the years 2006-07 and 2007-08. After that, it started increasing and in

the year 2010-11, revenue expenditure constituted more than 78.79 percent of total expenditure. There was relentless increase in expenditure on salaries, wages and pensions due to the implementation of new pay scale which led to an increase in revenue expenditure of the state government. During the second decade of the present century, revenue expenditure, on average, constituted more than 85 percent of the total expenditure of the state. This figure was slightly higher than the figure for the period in 2000s (80 percent). On the other hand, capital outlay constitutes a very small portion of total expenditure during the study period ranging from 9.39 percent in year 2019-20 to 24.22 percent in the year 2006-07. The average share of capital outlay to total expenditure is found to be slightly smaller during the time period 2010-11 to 2019-20 compared to the ratio in 2000s. Capital outlay, on an average, has constituted 14.69 percent of total expenditure during the second decade of the present century compared to 19.78 percent in 2000s. Loans and advances as provided by the state government are found to constitute, on an average, 0.19 percent of the total expenditure in 2000s compared to 0.03 percent during the time period 2010-11 to 2019-20. In other words, the average share of the loans and advances provided by the state government is found to be greater in 2000s than the second decade of the present century. The composition of total expenditure during the period under study is also shown in figure 3.2.

Figure 3.2
Composition of Total Expenditure of Government of Nagaland



It can be seen from figure 3.2 that revenue expenditure constitutes a major portion of the total expenditure during the period of study with periodic changes in the ratio. Decline in the ratio was observed in the year 2007-08 when revenue expenditure constituted 75.74 percent of total

expenditure. Decline in the share of revenue expenditure in that year was due to increase in the share of capital expenditure and loans and advances as seen in figure 3.2. Improvement in the share of capital outlay in the year 2006-07 can be explained by the fact that the state experienced sharp increase in capital expenditure under economic services. The increase in capital expenditure under economic services during 2006-07 was mainly due to investment in Transport (Rs.81.18 crore), Special areas programme (Rs.55.91 crore), Water Supply, Sanitation and Housing (Rs.45.57 crore) and Education, Sports, Art & Culture (Rs.10.05 crore).

To have a clearer idea about the changing composition of total expenditure, it is necessary to compute growth rate of these variables over the time period. The annual growth of each component of total expenditure of the state government has been computed for the study period. Additionally, decade wise compound growth rate has also been computed to have an idea about the comparative performance of the state in the two decades. The annual and compound growth rate of these variables has been provided in table 3.3.

Table 3.3

Annual and Compound Growth Rate of Components of Total Expenditure of the State

(In Percentage)

Year	Rev. Exp.	% to TE	Capital Exp	% to TE	Loans and Adv.	% to TE	Total Exp	Growth Rate (%)
2000-01	1290.23	84.22	224.4	14.65	17.35	1.13	1531.98	15.16
2001-02	1427.11	85.49	238.73	14.30	3.43	0.21	1669.27	8.96
2002-03	1506.27	81.45	340.69	18.42	2.33	0.13	1849.29	10.78
2003-04	1839.52	82.28	391.13	17.49	5.08	0.23	2235.73	19.46
2004-05	1684.63	81.60	379.44	18.38	0.34	0.02	2064.41	(-) 6.55
2005-06	2060.53	79.90	517.87	20.08	0.61	0.02	2579.01	24.93
2006-07	2222.15	75.77	710.48	24.22	0.24	0.01	2932.87	13.72
2007-08	2572.27	75.74	821.48	24.19	2.61	0.08	3396.36	15.8
2008-09	2889.54	77.18	853.09	22.78	1.46	0.04	3744.09	10.24
2009-10	3252.44	76.61	989.53	23.31	3.55	0.08	4245.52	13.39
2010-11	4187.84	78.79	1122.94	21.13	4.12	0.08	5314.9	25.19
2011-12	4875.66	79.57	1249.39	20.39	2.75	0.04	6127.8	15.29
2012-13	5601.39	81.67	1255.18	18.30	2.16	0.03	6858.73	11.93
2013-14	5750.34	82.64	1207.06	17.35	0.92	0.01	6958.32	1.45
2014-15	6762.41	86.86	1023.17	13.14	0.19	0.00	7785.77	11.89
2015-16	7581.92	87.74	1059.23	12.26	0.19	0.00	8641.34	10.98
2016-17	8651.94	88.94	1076.1	11.06	0.19	0.00	9728.23	12.58
2017-18	10191.35	88.88	1274.85	11.12	0.19	0.00	11466.39	17.89
2018-19	10919.98	87.21	1595.56	12.74	5.27	0.04	12520.81	9.19
2019-20	11637.02	90.54	1206.32	9.39	9.26	0.07	12852.6	2.65

CAGR 2000-01 to 2009-10	**9.69**		**16.00**		**-14.67**		**10.73**	
CAGR 2010-11 to 2019-20	**10.76**		**0.72**		**8.44**		**9.23**	
CAGR 2000-01 to 2019-20	**11.62**		**8.77**		**-3.09**		**11.22**	

CAGR: Cumulative Annual Growth Rate

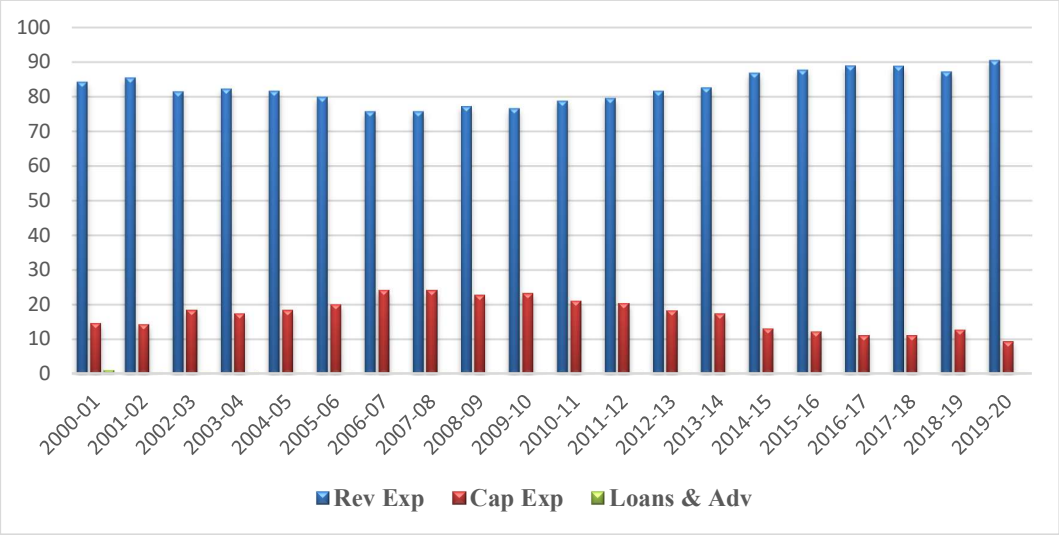
Source: State Finances Audit Report of the Comptroller and Auditor General of India C&AG)

From table 3.3 the growth rate of revenue expenditure of the state is found to be positive or moderately negative for most of the year during the period of study. But revenue expenditure has experienced moderate annual growth rate in the year 2006-07 and 2007-08 declined to 75.77 percent and 75.74 percent respectively. In the year 2006-07, the capital outlay as provided by the state government registered the highest ever growth rate amounting to 24.22 percent. the high capital outlay in 2006-07 was a result of a confluence of factors, including increased revenue, higher plan expenditure, and a focus on capital projects. There was an increase of 1.13 percent in loans and advances of the state government in the year 2000-01. The increase in loans and advances of the Nagaland state government in 2000-01 was primarily due to a significant rise in internal debt and loans/advances from the Central government. Specifically, internal debt increased by 151% and loans from the Central government by 73% during the five years ending 2000-01.

The compound growth rate of revenue expenditure in the second decade of the present century is found to be comparatively higher than the previous decade. There was an early impact of the reforms for the state during the first decade of the century where the state experienced a compound growth rate of capital expenditure of 16.00 percent during 2000-01 to 2009-10 compared to 0.72 percent during 2010s.

The comparatively high annual compound growth rate of capital expenditure in the first decade of the present century is mainly contributed by the high growth rate of this component of expenditure in the years 2006-07 and 2007-08. The high growth of capital expenditure may increase the developmental effectiveness of state government. But compound growth rate of the loans and advances provided by the state government is found to be negative during the first decade. This may be due to change in government policy whereby they stopped providing fresh loans to co-operative societies, corporations and different companies etc. The trend in the growth rate of different components of total expenditure is also shown in figure 3.3.

Figure 3.3
Annual Growth Rate of the Components of Total Expenditure



It is evident from figure 3.3 that the growth of revenue expenditure is comparatively uniform except in the year 2019-20. The growth rate of capital outlay and state government's lending is also found to be uniform during the study period.

3.4 Sectoral Composition of Total Expenditure

Sectoral composition shows that in the first decade of 21st century, maximum expenditure was on general services followed by economic and social services respectively. The share of economic services has increased followed by social and general services respectively. It shows a shift towards development expenditure from non-development expenditure. Share of loans and advances have also registered a declining trend throughout the study period. From the above observations it can be concluded that total expenditure has registered an increase (around stable ratio) to GSDP which indicates the stagnant growth of expenditure in comparison to state income (Table 3.4).

Table 3.4

Sectoral Composition of Total Expenditure (%)

Year	General Services	Social Services	Economic Services	Loan and Advances
2000-01	42.55	28.21	28.11	1.13
2001-02	44.21	28.52	27.06	0.21
2002-03	44.53	28.9	26.44	0.13
2003-04	41.87	25.37	32.53	0.23
2004-05	43.63	27.61	28.74	0.02
2005-06	38.84	27.43	33.71	0.02
2006-07	37.06	28.3	34.63	0.01
2007-08	39.18	27.91	32.83	0.08
2008-09	39.99	26.41	33.56	0.04
2009-10	41.85	24.94	33.12	0.09
2010-11	38.75	26.94	34.23	0.08
2011-12	41.66	24.37	33.92	0.05
2012-13	40.06	26.38	33.53	0.03
2013-14	41.85	29.13	29.01	0.01
2014-15	42.29	28.34	29.36	0.01
2015-16	43.14	27.56	29.3	0
2016-17	41.4	28.04	30.56	0
2017-18	40	26.55	33.45	0
2018-19	43.43	27.86	28.67	0.04
2019-20	43.53	27.13	29.27	0.07

Source: Annual Financial Statement (Budget) Actuals, Govt. of Nagaland

3.5 Pattern of Revenue Expenditure:

Generally speaking, revenue expenditure is an amount that is spent immediately - thereby being matched with revenues of the current accounting period. Revenue expenditure is incurred to maintain the current level of services and does not represent any addition to the state's service network. The importance of the revenue expenditure lies in the fact that it helps

to maintain and continue the existing level of services. For this, there should be proper allocation of expenditure on general services, social and community services, economic services and grants-in-aid (GIA) and contribution etc. The composition and trend of revenue expenditure of the state of Nagaland for the period under consideration has been provided in table 3.5.

It is evident from table 3.5 that major portion of the revenue expenditure of the state has been incurred on general services during the time period 2000-01 to 2019-20. During the period of study, revenue expenditure on general services is found to be comparatively higher than the expenditure on social and community services and economic services. The compound annual growth rate of general services was found to be 11.43 percent during the time period 2000-01 to 2019-20. For the same time period, expenditure on social and community services and economic services registered a compound growth rate of 11.38 percent and 12.24 percent respectively implying that growth rate of these components of expenditure is more than the growth rate of general services. Grants-in-Aid contribution has been less than one percent throughout the study period.

Revenue expenditure constitutes a major part of total expenditure. The analysis shows that barring one year revenue expenditure has registered an increasing trend throughout the study period. It has multiplied by more than 10 times with a growth rate trend of 12.57 per cent and compound annual growth rate of 11.62 per cent. Ratio to GSDP has uneven trend throughout the study period and was concentrated around 31 to 41 per cent. The ratio of revenue expenditure to revenue receipt has been more than 100 per cent up to 2003-2004. It indicates the financing of revenue expenditure by borrowed funds which cause increase in liability without creating assets. After 2003-04 position has improved. But again in 2019-20 the ratio increased to 101.87 per cent.

The relative share of different components of revenue expenditure reveals that expenditure on general services, which is non-developmental in nature, has been higher up to study period. After that the share of economic services is higher. Expenditure on social services registered less fluctuation comparatively. In recent years expenditure on social services has increased.

Table 3.5
Composition and Trend of Revenue Expenditure

(Rs. in Crore)

Year	Revenue Expenditure				Growth Rate (%)	(%) to GSDP	(%) Revenue Receipts (RR)	Buoyancy to		Per Capita RE (Rs)
	General Services	Social Services	Economic Services	Total Rev Exp				GSDP (%)	RR (%)	
2000-01	623.33	351.15	315.75	1290.23	13.10	35.07	102.88	2.68	7.85	6483.45
2001-02	723.88	377.18	326.05	1427.11	10.61	34.50	107.74	3.25	10.16	7171.28
2002-03	798.67	385.57	322.03	1506.27	5.55	31.72	111.83	5.72	20.16	7569.06
2003-04	874.91	422.32	515.76	1812.99	20.36	34.61	76.83	1.70	3.77	9110.34
2004-05	857.95	420.95	405.73	1684.63	-7.08	29.15	91.58	-4.12	-12.93	8465.32
2005-06	939.9	552.23	568.4	2060.53	22.31	32.32	90.88	1.45	4.07	10354.2
2006-07	1020.32	588.85	612.98	2222.15	7.84	31.94	80.15	4.07	10.22	11166.4
2007-08	1193.45	656.94	721.88	2572.27	15.76	31.85	85.86	2.02	5.45	12925.7
2008-09	1348.84	696.76	843.94	2889.54	12.33	30.62	84.96	2.48	6.89	14520
2009-10	1583.98	773.6	894.86	3252.44	12.56	31.66	87.44	2.52	6.96	16343.6
2010-11	1843.17	1125.72	1218.95	4187.84	28.76	35.61	83.76	1.24	2.91	21166.7
2011-12	2318.27	1154.12	1403.27	4875.66	16.42	35.18	87.28	2.14	5.31	24643.2
2012-13	2537.8	1461.79	1601.8	5601.39	14.88	35.73	90.28	2.40	6.07	28311.3
2013-14	2732.48	1701.56	1316.3	5750.34	2.66	32.40	88.50	12.18	33.28	29064.1
2014-15	3133.24	1855.17	1774	6762.41	17.60	33.65	88.39	1.91	5.02	34179.4
2015-16	3623.25	2093.61	1865.06	7581.92	12.12	38.83	94.26	3.20	7.78	38321.5
2016-17	3896.45	2295.21	2460.28	8651.94	14.11	39.83	91.63	2.82	6.49	43729.8
2017-18	4319.41	2558.56	3313.38	10191.4	17.79	41.61	92.49	2.34	5.20	51510.4
2018-19	5018.11	3158.59	2743.28	10920	7.15	40.02	95.48	5.60	13.35	55193.2
2019-20	5428.8	3030.05	3178.17	11637	6.57	38.14	101.87	5.81	15.51	58817.3
CAGR 2000-01 to 2009-10	**9.77**	**8.22**	**10.98**	**9.69**						**9.69**
CAGR 2010-11 to 2019-20	**11.41**	**10.41**	**10.06**	**10.76**						**10.76**
CAGR 2000-01 to 2019-20	**11.43**	**11.38**	**12.24**	**11.62**						**11.66**

Sources: State Finances Audit Report of the Comptroller and Auditor General of India

3.5.1 Pattern of Revenue Expenditure on General Services

As expenditure on general services has constituted a major portion of the revenue expenditure, it is necessary to analyse the composition of revenue expenditure on general services. The composition of revenue expenditure on general services during the study period has been provided in table 3.6.

Table 3.6
Revenue Expenditure of Government of Nagaland on General Services

(In Percentage)

Year	Organs of State	Fiscal Services	Interest Paymnt & Servicing of Debt	Admin. Services	Pension and Miscl. Services	Total Gen Service Exp (Rs. in crore)	GSE/ GSDP	% to TE
2000-01 (RE)	2.81	2.53	28.41	53.13	13.12	682.92	0.19	44.58
2001-02	2.98	2.14	27.69	51.61	15.58	723.88	0.17	43.37
2002-03	3.09	2.06	26.87	51.21	16.77	798.67	0.17	43.19
2003-04	2.78	2.16	26.83	52.06	16.17	874.91	0.17	39.13
2004-05	3.32	1.88	29.09	50.03	15.68	857.95	0.15	41.56
2005-06	2.80	2.25	27.01	48.75	19.18	939.9	0.15	36.44
2006-07	2.61	2.24	27.41	47.82	19.91	1020.32	0.15	34.79
2007-08	3.06	1.81	24.27	48.96	21.89	1193.44	0.15	35.14
2008-09	2.43	1.99	24.80	53.69	17.10	1348.84	0.14	36.03
2009-10	2.64	1.76	24.29	53.54	17.77	1583.98	0.15	37.31
2010-11 (RE)	2.40	2.06	22.39	52.23	20.92	1924.24	0.16	36.20
2011-12	2.57	2.09	19.26	50.63	25.46	2318.27	0.17	37.83
2012-13	3.01	1.80	18.98	49.41	26.80	2537.8	0.16	37.00
2013-14 (RE)	3.00	2.12	20.37	49.34	25.17	2799.42	0.16	40.23
2014-15	2.29	1.72	19.03	47.95	29.00	3133.24	0.16	40.24
2015-16	2.20	1.65	21.72	45.92	28.51	3623.25	0.19	41.93
2016-17	2.39	1.67	22.08	45.67	28.19	3896.45	0.18	40.05
2017-18	4.83	2.25	29.59	63.33	41.59	4319.40	0.17	37.67
2018-19	3.74	1.51	19.86	43.83	31.06	5018.12	0.18	40.08
2019-20	2.27	1.53	17.75	44.97	33.47	5428.79	0.18	42.24

Source: Annual Financial Statement (Budget) Actuals, Govt. of Nagaland

It is evident from table 3.6 that interest payments and servicing of debt, administrative services and pension constitute major portion of the expenditure on general services during the period of study. These three components together constitute more than 95 percent of the revenue expenditure on general services during the study period. The compound growth rate of expenditure on interest payments, administrative services and pension during the time period 2000-01 to2019-20 is found to be 8.34, 10 and 16.24 percent respectively. The growth rate of revenue expenditure on administrative services in the second decade of the present century was found to be slightly lower than in 2000s (51.8: 47.47 Percent). The initiative by the Finance Commissions of India to reduce the interest burden of the state governments may contribute towards reduction of growth rate of interest payments of the state during the time period 2000-01 to 2019-20.

3.5.2 Pattern of Revenue Expenditure, Social and Community Services

Apart from the expenditure on general services, it is necessary to analyse the composition of revenue expenditure on social and community services and economic services which has a positive impact on the economic development of the state. The composition of expenditure on social and community services has been provided in table 3.7.

Table 3.7
Composition of Social and Community Services Expenditure (SCSE) (%)

Year	Education, Sports, Art & Culture	Medical, Family Plan, Public Health and Sanitation	Others*	Total (Rs. in cores)	% of SCSE to TE
2000-01	49.24	25.62	25.14	348.65	22.76
2001-02	55.59	24.34	20.07	377.18	22.60
2002-03	51.95	24.12	23.93	385.57	20.85
2003-04	58.29	18.54	23.17	422.31	18.89
2004-05	56.94	24.76	18.30	4209.5	20.39
2005-06	53.75	25.64	20.61	552.23	21.41
2006-07	56.88	24.39	18.73	588.85	20.08
2007-08	57.81	21.96	20.23	656.95	19.34
2008-09	56.82	24.21	18.97	696.76	18.61
2009-10	59.56	23.15	17.29	773.61	18.22
2010-11	61.36	20.38	18.26	1167.73	21.97
2011-12	56.73	20.97	22.30	1137.94	18.57
2012-13	57.09	21.92	20.99	1139.88	16.62
2013-14	60.14	18.93	20.93	1745.57	25.09
2014-15	61.58	17.91	20.50	1890.43	24.28
2015-16	59.96	22.07	17.97	2377.44	27.51
2016-17	60.16	23.41	16.44	2809.00	28.87
2017-18	57.94	24.55	17.51	2558.56	22.31
2018-19	54.17	24.07	21.76	3305.74	26.40
2019-20	56.66	23.91	19.43	3448.69	26.83

Source: Annual Financial Statement (Budget) Actuals, Govt. of Nagaland

It is evident from table 3.7 that the expenditure on education, sports, art and culture has constituted the major portion of the revenue expenditure on social and community services during the time period 2000-01 to 2019-20. On average, it constitutes 57.13 percent of the total revenue expenditure on social services during the period of study. But fluctuations were

noticed in the share of expenditure on education, sports, art and culture during the period of study. In the year 2019-20, the expenditure on education, sport, art and culture constituted 56.66 percent of the total expenditure on social and community services compared to 49.24 percent in the year 2000-01. The expenditure on medical, family plan, public health and sanitation constitutes, on average, 22.74 percent of the total revenue expenditure on social and community services during the study period. The compound growth rate of medical, family plan, public health and sanitation is found to be slightly lower than the compound growth rate of expenditure on education, sports, art and culture during the period taken for the analysis (12.95:11.75).

3.5.3 Pattern of Revenue Expenditure, Economic Services:

As the state suffers from lots of bottlenecks particularly in the infrastructure sector, it is necessary that the state should spend sufficiently on economic services to remove those bottlenecks. The amount of revenue expenditure on different economic services of the state has been provided in table 3.8.

It is evident from table 3.8 that agriculture and allied activities have constituted the major portion of the revenue expenditure on economic services during the period of study. Although the share of this sector has declined due to low growth rate compared to the other components, it still constitutes 26.32 percent of the revenue expenditure on economic services during the years 2000-01 to 2019-20. Increase in the share of rural development has been observed during the period of study. The share of expenditure on rural development has increased from 3.95 percent in the year 2000-2001 to 25.59 percent in the year 2019-20. The compound growth rate of this component of expenditure during the time period 2010-11 to 2019-20 is found to be 9.19 percent compared to 10.43 percent in 2000s. The compound growth rate of Science and Technology and Environment is found to be the highest among all categories of expenditure as it registered a compound growth rate of 21.47 percent during the study period. Energy is found to be another significant component which shares, on average, 19.19 percent of the revenue expenditure on economic services during the study period.

Table 3.8

Composition of Economic Services Expenditure (in percentage)

Year	Agr. & Allied Activities	Rural Dev.	Special Area Prog.	Irrig. & Flood Contrl.	Energy	Indstry & Mineral	Transp & Comm.	Science Tech. & Envirn.	Genl Econ. Services	Total ESE (Rs. in crore)
2000-01	29.46	16.94	3.25	2.40	16.95	9.55	7.77	0.09	13.59	331.66
2001-02	36.88	3.95	3.39	4.13	18.12	13.39	5.21	0.56	14.38	326.06
2002-03	31.75	7.73	6.22	4.18	18.04	8.60	7.94	0.70	14.83	322.04
2003-04	21.38	12.82	3.83	4.13	30.81	7.37	4.57	0.62	14.47	515.76
2004-05	28.90	12.76	3.52	5.47	23.24	7.90	4.86	0.68	12.67	405.73
2005-06	28.69	15.35	2.89	4.41	17.10	7.63	13.39	0.40	10.15	568.40
2006-07	29.78	11.40	4.00	5.43	18.55	7.05	12.40	1.06	10.34	612.98
2007-08	28.46	12.36	4.98	8.72	16.35	5.48	12.86	0.35	10.44	721.88
2008-09	24.59	14.00	9.31	8.08	18.04	5.87	13.92	1.54	4.65	843.94
2009-10	29.75	10.71	7.54	7.85	18.95	6.62	13.15	0.51	4.93	894.86
2010-11	26.74	10.15	7.15	12.73	16.79	4.88	10.50	0.61	10.45	1319.30
2011-12	25.92	6.79	6.85	9.40	20.98	5.27	14.19	0.51	10.08	1403.26
2012-13	25.65	8.22	6.80	7.98	21.56	5.66	14.03	0.53	9.59	1601.80
2013-14	23.17	10.40	8.40	9.81	19.26	4.77	14.60	0.69	8.91	1620.22
2014-15	26.89	15.66	5.64	3.49	19.39	4.40	14.75	0.52	9.25	1774.00
2015-16	23.11	17.35	1.10	1.49	19.97	5.71	22.04	0.46	8.77	1865.06
2016-17	19.59	32.94	1.09	1.08	17.54	4.18	16.19	0.38	7.00	2462.41
2017-18	18.88	40.94	1.58	0.84	13.60	3.69	13.71	0.30	6.46	3313.38
2018-19	25.28	22.67	1.11	1.14	17.87	4.96	15.97	0.45	10.56	2743.28
2019-20	24.64	25.59	1.17	0.98	18.42	4.36	14.17	0.44	10.22	3178.17

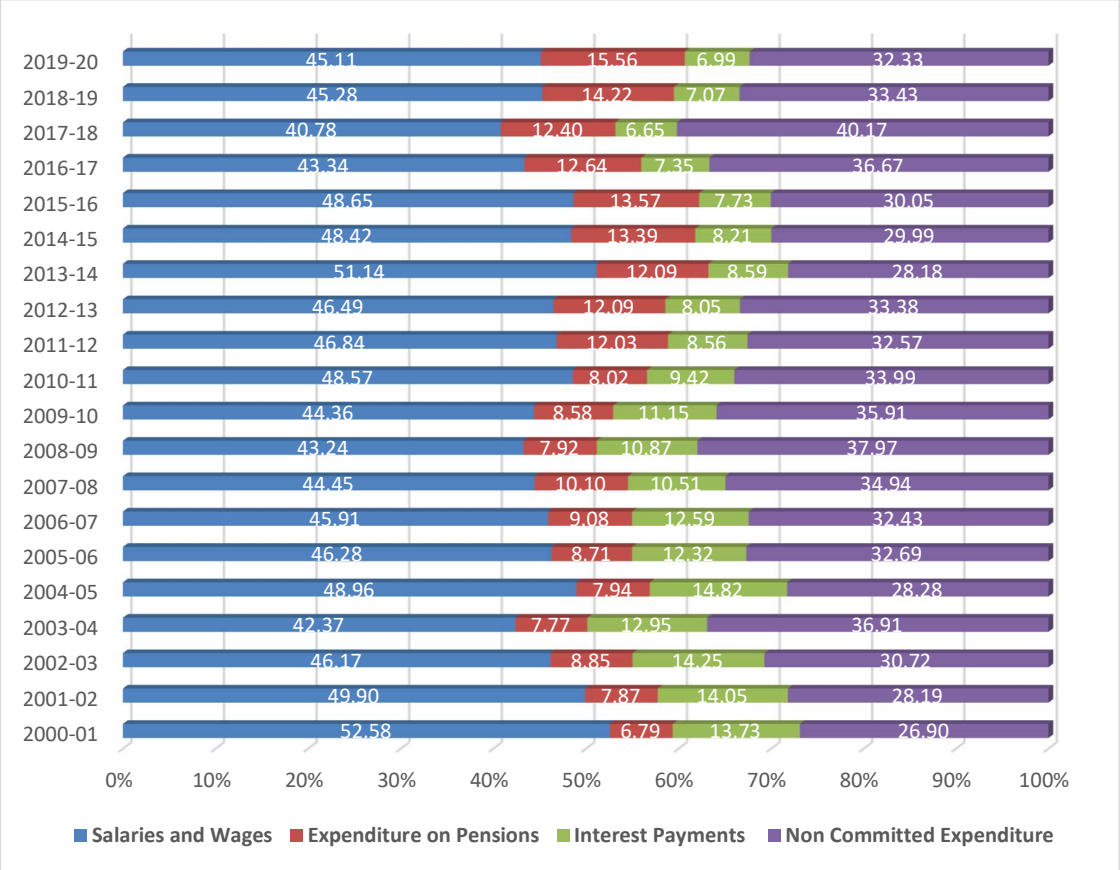
Source: Annual Financial Statement (Budget) Actuals, Govt. of Nagaland

3.6 Committed expenditure

The committed expenditure of the State Government on revenue account consists of interest payments; expenditure on salaries and wages; and pensions. It has first charge on Government resources. Upward trend on committed expenditure leaves the Government with lesser flexibility for development sector. Table 3.9 presents the trends in the components of committed expenditure during 2000-01 to 2019-20. Percentage of committed expenditure to Revenue Receipts and Revenue Expenditure during 2000-01 to 2019-20 is given in Chart 3.4.

Figure 3.4

Percentage of committed expenditure to Revenue Expenditure during 2000-01 to 2019-20



As can be seen from details in figure 3.4 and table 3.9, the committed expenditure constituted 60 per cent or more of Revenue Expenditure during the study period from 2000-01 to 2019-20. The percentage of salaries, pensions and interest payments within Revenue Expenditure was highest in 2000-01 (73.10 percent) while the percentage of non committed expenditure to RE was the highest in 2017-18 during the period. It signifies limited flexibility of the State to allocate and spend on areas of non committed expenditure.

Table 3.9
Committed Expenditure

(Rs. in Crore)

Year	Components of Committed Expenditure			As a *percentage* Revenue Receipts (RR)			As a *percentage* of Revenue Expenditure (RE)		
	Salaries and Wages	Expenditure on Pensions	Interest Payments	Salaries and Wages	Expenditure on Pensions	Interest Payments	Salaries and Wages	Expenditure on Pensions	Interest Payments
2000-01	678.46	87.56	177.09	54.1	6.98	14.12	52.58	6.79	13.73
2001-02	712.09	112.26	200.47	53.76	8.48	15.14	49.9	7.87	14.05
2002-03	695.52	133.38	214.58	51.64	9.9	15.93	46.17	8.85	14.25
2003-04	768.19	140.81	234.74	32.55	5.97	9.95	42.37	7.77	12.95
2004-05	824.78	133.83	249.62	44.84	7.28	13.57	48.96	7.94	14.82
2005-06	953.71	179.42	253.89	42.07	7.91	11.2	46.28	8.71	12.32
2006-07	1020.08	201.74	279.69	36.8	7.28	10.09	45.91	9.08	12.59
2007-08	1143.25	259.73	270.46	38.17	8.67	9.03	44.45	10.10	10.51
2008-09	1249.39	228.96	313.99	36.75	6.73	9.24	43.24	7.92	10.87
2009-10	1442.85	279.06	362.51	38.8	9.75	7.5	44.36	8.58	11.15
2010-11	2033.93	335.97	394.33	40.69	6.72	7.89	48.57	8.02	9.42
2011-12	2283.75	586.68	417.39	40.89	10.51	7.47	46.84	12.03	8.56
2012-13	2603.87	677.03	450.64	41.98	10.92	7.27	46.49	12.09	8.05
2013-14	2940.8	695.11	493.84	45.27	10.7	7.6	51.14	12.09	8.59
2014-15	3274.16	905.15	555.34	42.81	11.83	7.26	48.42	13.39	8.21
2015-16	3,688.50	1,028.80	586.45	45.87	12.79	7.29	48.67	13.57	7.74
2016-17	3,750.05	1,093.47	635.5	39.73	11.58	6.73	43.36	12.64	7.35
2017-18	4,155.72	1,264.10	677.75	37.71	11.47	6.15	40.78	12.4	6.65
2018-19	4,944.95	1,552.79	771.74	43.23	13.58	6.75	45.28	14.22	7.07
2019-20	5,249.81	1,810.91	813.74	45.96	15.85	7.12	45.11	15.56	6.99

Source: State Finances Audit Report of the CAG for different years

126

3.7 Pattern of Capital Expenditure:

Capital expenditure is the amount spent on acquiring or improving long-term assets such as equipment or buildings. For a proper analysis of capital expenditure, it is necessary to differentiate between capital expenditure and capital outlay. Capital outlay is that part of the capital expenditure which is used for different activities of the state government which are of capital nature (RBI, 2007). As mentioned in section 3.7, capital outlay excludes expenditures such as discharge of internal debt and repayment of loans to centre. Actually, it is capital outlay that leads to creation of long-term assets (Sarma, 2004). The higher proportion of capital outlay to capital expenditure helps in development of social and economic infrastructure of a state. The amount and percentage of capital outlay to total capital expenditure of the state government has been provided in table 3.10.

Table 3.10
Amount of Capital Expenditure and Capital Outlay of the State Government
(Rs. in crore)

Year	Capital Expenditure	Capital Outlay	Percentage of capital outlay to Capital Expenditure
2000-01	241.75	224.4	92.82
2001-02	242.16	238.73	98.58
2002-03	343.02	340.69	99.32
2003-04	396.21	391.13	98.72
2004-05	379.78	379.44	99.91
2005-06	518.48	517.87	99.88
2006-07	710.72	710.48	99.97
2007-08	824.09	821.48	99.68
2008-09	854.55	853.09	99.83
2009-10	993.08	989.53	99.64
2010-11	1127.06	1122.94	99.63
2011-12	1252.14	1249.39	99.78
2012-13	1257.34	1255.18	99.83

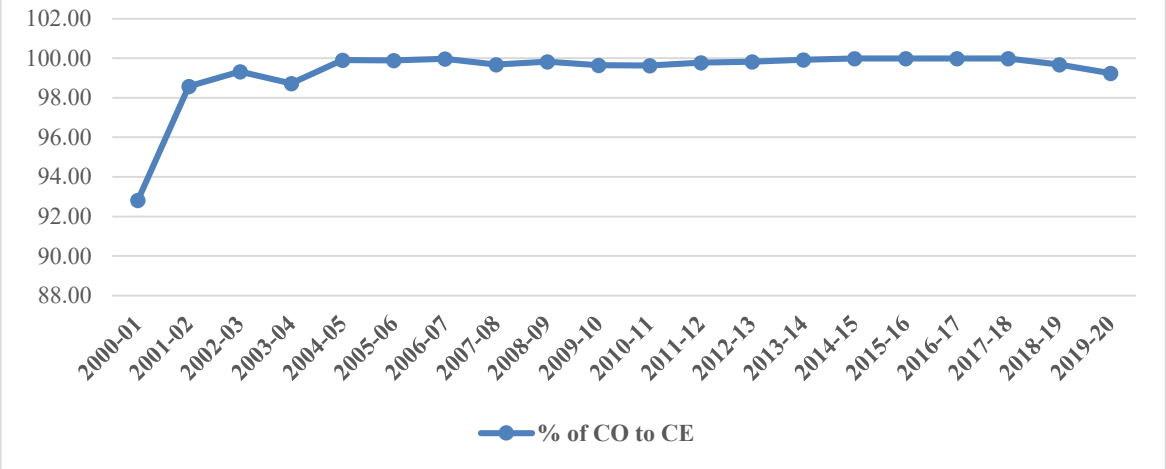
2013-14	1207.98	1207.06	99.92
2014-15	1023.36	1023.17	99.98
2015-16	1059.42	1059.23	99.98
2016-17	1076.29	1076.1	99.98
2017-18	1275.04	1274.85	99.99
2018-19	1600.83	1595.56	99.67
2019-20	1215.58	1206.32	99.24

Source: State Finances Audit Report of the Comptroller and Auditor General of India (C&AG)

It is evident from table 3.10 that a major portion of the capital expenditure has been spent on repayment of public debt during most of the years under study. During 2000s, capital outlay constituted, on average, 98.84 percent of the total capital expenditure implying that there had been huge burden of repayment of public debt during that period. This has increased more during recent years. Capital outlay has constituted 99.98 and 99.99 percent of the capital expenditure in the years 2016-17 and 2017-18 respectively. This is mainly due to the improvement of the fiscal situation of the state in recent years. This allows the state government to invest more on capital assets. The recent initiative by the central government to reduce the debt burden of the state governments also helped to reduce the share of repayment of public debt. The State received debt relief under the 'Debt Consolidation and Relief Facility (DCRF) Scheme' in the year 2005-2010. This scheme was recommended by the Twelfth Finance Commission (TFC) and aimed to help states manage their debt burden. The DCRF involved consolidating central loans for a longer tenure and providing relief based on fiscal performance. All the factors contributed towards increased capital outlay of the state in those years. This ratio of capital outlay to capital expenditure of the state is also shown in figure 3.5.

Figure 3.5

Percentage of Capital Outlay to Capital Expenditure



It can be seen from figure 3.5 that the ratio of capital outlay to capital expenditure has increased during the period of study. The improvement is found to be significant particularly during the time period 2014-15 to 2017-18 when capital outlay, on an average, constituted 99.98 percent of the capital expenditure. Improvement in the ratio of capital outlay to capital expenditure in the above time period is mainly due to reduction in repayment obligations of the state government. Prior to that, the average ratio of capital outlay to capital expenditure of the state was found to be 99.11 percent during the time period 2000-01 to 2013-14.

3.8 Composition of Capital Outlay on Different Services:

The composition of capital outlay on different services provides information about the quality of capital outlay of a state (Das Gupta, 2012). The composition of capital outlay in terms of general services, social services and economic services has been provided in table 3.11

Table 3.11
Composition of Capital Outlay of Government of Nagaland

(Rs. in crore)

Year	General Services	Social Services	Economic Services	Total Capital Outlay
2000-01	28.51	81.02	114.87	224.4
2001-02	14.25	98.87	125.6	238.73
2002-03	24.78	148.91	167	340.69
2003-04	50.05	138.15	202.93	391.13
2004-05	42.8	148.97	187.67	379.44
2005-06	61.84	155.09	300.94	517.82
2006-07	67.16	240.97	402.37	710.48
2007-08	137.72	290.81	392.95	821.48
2008-09	149.15	291.78	412.16	853.09
2009-10	193.58	285.02	510.93	989.53
2010-11	217.17	306.09	599.68	1122.94
2011-12	235.75	338.77	674.87	1249.39
2012-13	211.01	346.81	697.36	1255.18
2013-14	181.19	324.47	701.4	1207.06
2014-15	160.95	350.99	511.23	1023.17
2015-16	105.78	287.49	665.96	1059.23
2016-17	132.55	431.73	511.82	1076.1
2017-18	267.1	485.68	522.07	1274.85
2018-19	419.49	329.89	846.18	1595.56
2019-20	165.73	457.02	583.57	1206.32
CAGR 2000-01 to 2009-10	**21.11**	**13.40**	**16.10**	**16.00**
CAGR 2010-11 to 2019-20	**-2.67**	**4.09**	**-0.27**	**0.72**
CAGR 2000-01 to 2019-20	**9.20**	**9.04**	**8.47**	**8.77**

Source: Annual Financial Statement (Budget) Actuals, Govt. of Nagaland

From table 3.11, it is evident that expenditure on economic services constitutes the major portion of total capital outlay during the study period. The compound growth rate of this component of expenditure is found to be 8.47 percent during the period 2000-01 to 2019-20. For the same time period, the compound growth rate of general and social services is found to be 9.20 percent and 9.04 percent respectively implying that the

growth rate of these components of expenditure is comparatively higher than the growth rate of capital expenditure on economic services. As economic services constitute a major portion of the capital outlay, it is necessary to analyse the pattern and composition of expenditure on economic services. The composition and pattern of capital expenditure on economic services has been provided in table 3.12.

From table 3.12, increase in capital outlay on economic services has been noticed during the time period from 2010-11 to 2019-20 compared to the previous decade. The state registered a compound growth of - 0.82 percent on capital expenditure on economic services during the time period 2010-11 to 2019-20 compared to 12.20 percent in the previous decade. Transport and Communication expenses constitute the major portion of the capital outlay of the state during the period of study. It contributed, on average, 41.24 percent of the total capital expenditure on economic services during the study period. The Special Areas Programme constituted, on average, 21.46 percent of the total capital outlay on economic services for the study period. Capital outlay on industry and minerals is found to be comparatively low for the entire time period taken for the study. Although it registered a high growth rate during 2008-09 to 2010-11, it shared only 6.65 percent of the capital expenditure on economic services during the period of study. The share of agriculture and allied activities has been increasing till 2013-14, indicating that greater importance is assigned to this sector.

Table 3.12

Capital Outlay on Economic Services of the State ***(Rs. in lakh)***

Year	Agri & Allied	Rural Dev	Spcl. Areas Program	Irrig. & Flood Control	Energy	Industry & Minerals	Transpt and Comm.	Science, Tech & environ	General Econ. Services	Total
2000-01 (RE)	22.1	0.25	13.67	0	46.54	16.17	62.81	0	0.01	161.55
2001-02	13.58	0.1	13.24	0	54.35	8.31	35.95	0	0.07	125.6
2002-03	12.88	0.19	10.13	5.2	74.27	17.44	46.68	0.02	0.18	166.99
2003-04	20.63	0.25	29.7	0.01	60.74	24.41	66.87	0.12	0.2	202.93
2004-05	9.38	0	42.25	1.08	44.42	13.37	69.12	0.48	7.56	187.66
2005-06	41.46	0.5	57.59	0.82	76.2	33.35	86.36	0.5	4.16	300.94
2006-07	39.47	0	113.5	0.96	46.47	26.83	167.54	0.5	7.1	402.37
2007-08	38.58	0	76.82	2.88	50.27	30.21	187.98	2.68	3.52	392.94
2008-09	42.92	0.88	83.61	8.98	108.8	52.77	107.4	1.7	5.09	412.15
2009-10	29.36	0.00	97.23	1.75	71.27	45.93	259.68	1.99	3.72	510.93
2010-11 (RE)	72.26	0.50	102.39	2.46	82.85	54.53	289.71	1.00	28.05	633.76
2011-12	79.30	0.00	92.33	0.47	85.84	38.58	352.46	0.00	25.89	674.86
2012-13	98.92	1.33	109.34	1.33	91.33	33.79	356.68	0.00	4.66	697.36
2013-14 (RE)	96.32	0.73	190.71	6.01	99.54	44.33	322.32	0.00	15.77	775.72
2014-15	20.02	0	100.1	14.77	51.12	25.57	277.85	1.76	20.04	511.23
2015-16	18.19	0	209.55	98.18	63.2	15.17	254.32	1.88	5.47	665.96
2016-17	14.89	0.00	228.90	39.62	3.32	13.42	175.19	1.00	5.49	511.82
2017-18	29.57	0.00	209.27	17.46	21.70	15.88	221.38	0.89	5.93	522.07
2018-19	17.27	0.96	200.51	35.55	95.59	3.59	486.22	3.72	2.78	846.18
2019-20	24.89	1.00	181.13	30.67	53.34	7.22	275.16	2.66	7.50	583.57
CAGR 2000-01 to 2009-10	**2.88**	**-100.00**	**21.68**	**-12.74**	**4.35**	**11.00**	**15.25**	**77.71**	**80.74**	**12.20**
CAGR 2010-11 to 2019-20	**-10.11**	**7.18**	**5.87**	**28.71**	**-4.31**	**-18.31**	**-0.51**	**10.28**	**-12.36**	**-0.82**
CAGR 2000-01 to 2019-20	**0.60**	**7.18**	**13.79**	**10.36**	**0.68**	**-3.95**	**7.67**	**31.22**	**39.24**	**6.63**

Source: Annual Financial Statement (Budget) Actuals, Govt. of Nagaland

The above discussion gives an idea about the pattern and growth of expenditure of the state during the period of study. While the growth in public expenditure is important, the quality of expenditure is of more significance from the point of view of overall economic development. As such, an attempt has been made in the following section to

examine the quality of public expenditure in the state.

3.9 Regression Analyses of Revenue Expenditure and Capital Outlay on GSDP

Table 3.13

1. Regression of Revenue Expenditure on GSDP

Revenue Expenditure	Coefficient	Standard Error	t	P>|t|	
GSDP	0.4062848	0.011728	34.64	0.000	
Constant	-586.1919	183.3092	-3.20	0.005	
R^2	0.9852	**Source**	**ss**	**df**	**ms**
Adjusted R^2	0.9844	**Model**	216501930	1	216501930
Number of Observation	20	**Residual**	3247310.85	18	180406.158
		Total	219749240	19	11565749.5

2. Regression of Capital Outlay on GSDP

Capital Outlay	Coefficient	Standard Error	t	P>|t|	
GSDP	0.041267	0.0060787	6.79	0.000	
Constant	325.1541	95.00984	3.42	0.003	
R2	0.7191	**Source**	**ss**	**df**	**ms**
Adjusted R2	0.7035	**Model**	2233604.97	1	2233604.97
Number of Observation	20	**Residual**	872353.888	18	48464.1049
		Total	3105958.85	19	163471.519

*Calculated using **STATA 17***

The above regression analyses examines the relationship between Nagaland's Gross State Domestic Product (GSDP) and two key expenditure components: revenue expenditure and capital outlay. The analyses are based on 20 observations, providing insights into the state's fiscal dynamics and spending patterns.

3.9.1 Revenue Expenditure on GSDP Regression Analysis

The regression of revenue expenditure on GSDP demonstrates an exceptionally strong relationship with an R^2 of 0.9852 (98.52%). This indicates that GSDP explains nearly

all the variation in revenue expenditure, suggesting a highly predictable spending pattern.

Coefficient Analysis

GSDP Coefficient: 0.4063

- For every ₹1 crore increase in GSDP, revenue expenditure increases by approximately ₹40.63 lakh
- The coefficient is highly statistically significant with a t-statistic of 34.64 and p-value of 0.000
- Standard error of 0.0117 indicates high precision in the estimate

Constant Term: -586.19

- Represents the theoretical revenue expenditure when GSDP is zero
- Also statistically significant (t = -3.20, p = 0.005)
- This negative intercept suggests fixed costs or structural adjustments in the expenditure pattern

Model Quality Assessment

Metric	Value	Interpretation
R^2	0.9852 (98.52%)	Excellent model fit
Adjusted R^2	0.9844 (98.44%)	Confirms robust relationship
F-statistic	Very high	Model is statistically significant
Degrees of Freedom	18	Adequate sample size for inference

The minimal difference between R^2 and Adjusted R^2 (0.0008) confirms that the high explanatory power is not due to overfitting.

3.9.2 Capital Outlay on GSDP Regression Analysis

The capital outlay regression shows a moderate relationship with GSDP, achieving an R^2 of 0.7191 (71.91%). This indicates that while GSDP is a significant predictor, there's more variability in capital spending decisions compared to revenue expenditure.

Coefficient Analysis

GSDP Coefficient: 0.0413

- For every ₹1 crore increase in GSDP, capital outlay increases by approximately ₹4.13 lakh
- Highly statistically significant with t-statistic of 6.79 and p-value of 0.000
- Standard error of 0.0061 shows reasonable precision

Constant Term: 325.15

- Positive intercept suggesting baseline capital expenditure independent of GSDP
- Statistically significant (t = 3.42, p = 0.003)

Model Quality Assessment

Metric	Value	Interpretation
R^2	0.7191 (71.91%)	Good model fit
Adjusted R^2	0.7035 (70.35%)	Solid relationship after adjustment
Residual Variation	Higher than revenue model	More unpredictable spending pattern

3.9.3 Comparative Analysis

Spending Elasticity

Expenditure Type	GSDP Coefficient	Spending Rate
Revenue Expenditure	0.4063	40.63% of GSDP growth
Capital Outlay	0.0413	4.13% of GSDP growth

Revenue expenditure shows nearly 10 times higher responsiveness to GSDP changes compared to capital outlay, reflecting Nagaland's expenditure structure where recurring costs dominate.

Model Reliability

The revenue expenditure model is significantly more reliable (R^2 = 98.52%) than the capital outlay model (R^2 = 71.91%). This suggests that:

1. Revenue expenditure follows predictable patterns tied to economic growth
2. Capital expenditure involves more discretionary decisions influenced by policy priorities, project availability, and fiscal constraints.

3.9.4 Policy Implications

Fiscal Structure

Considering the budgetary context of Nagaland and these regression results:
1. High Dependency on Revenue Expenditure: According to the high GSDP-revenue expenditure association (0.4063 coefficient), committed expenditures such as salaries and pensions account for around 37.32% of GSDP, which is spent on revenue expenditures.
2. Restrictions on Capital Investment: Given the high committed expenditure burden in Nagaland, the lower capital outlay coefficient (0.0413) indicates little fiscal room for developmental spending.

3. Predictable vs. Variable Spending: While capital spending has a moderate R2, indicating it is more dependent on fiscal policy decisions and the availability of outside funds, revenue expenditures have a high R2, indicating automatic growth with the economy.

Fiscal Management

1. Revenue Optimization: Because of the close connection, increasing GSDP growth directly raises the capacity for revenue expenditure.

2. Capital Investment Strategy: Through improved fiscal planning, the modest relationship points to opportunities to boost capital expenditures' responsiveness to economic development.

3. Structural Reforms: In order to increase fiscal space, committed expenditures must be controlled, as indicated by the high revenue expenditure coefficient.

In Nagaland's economic growth strategy, both regression models show statistically significant associations, offering trustworthy frameworks for budgetary planning and spending forecasting.

3.10 Quality of expenditure of the State

Quality of expenditure is basically related to proper allocation of expenditure on different heads. The availability of resources for improvement in social and physical infrastructure of the state generally reflects the quality of expenditure (Howes and Jha, 2004; Sen and Karmakar, 2008). The improvement in the quality of expenditure basically involves two aspects, viz., adequacy of expenditure (adequate provision for providing public services) and efficiency of expenditure use. Getting the right size and right composition of government expenditure to achieve the highest attainable growth rates after meeting the government’s obligations is known as the adequacy of expenditure. The efficiency of public expenditure relates to both size and sectoral allocations aimed at removing inefficiencies arising from misallocations, and implementation of the schemes and delivery of services. In view of the importance of these factors, the Thirteen Finance Commission gave importance on the need to improve

the quality of public expenditure to obtain better outputs and outcomes (TFC, 2009). It is necessary to determine whether the public expenditure of the state government is adequate enough to meet the social and economic responsibilities of the government.

3.11 Adequacy of Public Expenditure

The amount of fund available for social and economic services after meeting the expenditure on general services actually implies the adequacy of expenditure of a state, which is popularly known as developmental expenditure (Gupta and Sarkar, 1994; Das Gupta, 2012). The quality of expenditure in terms of adequacy can be assessed by the total developmental revenue and capital expenditure of the state government during the period of study. The development expenditure as a ratio of total and aggregate expenditure as well as GSDP of the state has been computed to examine the relative growth of development expenditure with respect to the above-mentioned variables. Apart from the components of total expenditure, aggregate expenditure includes expenditure on repayment of public debt. The amount and growth of developmental revenue and capital expenditure as well as development expenditure (DE) of the state has been provided in table 3.14.

Table 3.14
Amount and Growth of Developmental Expenditure (DE) of the State

(Rs. in crore)

Year	Total Development Revenue Expenditure	Total Development Capital Expenditure	Development Expenditure	Annual Growth Rate	DE as percentage of total Expenditure	DE as a percentage of GSDP
2000-01	737.32	310.92	1048.24	-	68.42	28.49
2001-02	731.23	392.26	1123.49	7.18	67.30	27.16
2002-03	707.61	315.91	1023.52	-8.90	55.35	21.55
2003-04 (RE)	876.11	478.46	1354.57	32.34	61.31	25.86
2004-05	826.68	336.64	1163.32	-14.12	56.35	20.13
2005-06	1120.61	456.03	1576.64	35.53	61.13	24.73
2006-07	1201.83	643.32	1845.15	17.03	62.91	26.52

2007-08	1378.81	683.77	2062.58	11.78	60.75	25.54
2008-09	1540.69	703.93	2244.62	8.83	59.97	23.79
2009-10	1668.44	795.96	2464.40	9.79	58.06	23.99
2010-11	2344.65	905.77	3250.42	31.89	61.17	27.64
2011-12	2557.39	1013.64	3571.03	9.86	58.29	25.77
2012-13	3063.59	1044.17	4107.76	15.03	59.91	26.20
2013-14	3019.47	1025.88	4045.35	-1.52	58.16	22.79
2014-15	3629.17	862.22	4491.39	11.03	57.70	22.35
2015-16	3958.68	953.46	4912.14	9.37	56.86	25.16
2016-17 (RE)	5335.49	1142.54	6478.03	31.88	66.61	29.82
2017-18	5871.94	1007.75	6879.69	6.20	60.00	28.09
2018-19	5901.87	1176.08	7077.94	2.88	56.53	25.94
2019-20	6208.22	1040.59	7248.81	2.41	56.40	23.76
CAGR 2000-01 to 2009-10	**8.51**	**9.86**	**8.92**			
CAGR 2010-11 to 2019-20	**10.23**	**1.40**	**8.35**			
CAGR 2000-01 to 2019-20	**11.24**	**6.23**	**10.15**			

Source: Reserve Bank of India, State Finances - Study of Budgets of different years

It is evident from table 3.14 that developmental revenue expenditure of the state government has increased from Rs. 737.32 crore in 2000-01 to Rs. 6208.22 crore in 2019-20 and thus registering a compound growth rate of 11.24 percent. The compound growth rate of developmental capital expenditure of the state during the study period is found to be 6.23 percent as it has increased from Rs. 310.92 crore in 2000-01 to Rs. 1040.59 crore in 2019-20. The high growth rate of developmental revenue expenditure compared to developmental capital expenditure implies that the state has put less effort into creating capital assets during the period of study. Compared to this, the compound growth rate of developmental revenue and capital expenditure of all states is found to be 12.74 and 15.72 percent respectively during the above-mentioned period (RBI, 2011). Again, the compound growth rate of developmental expenditure of the state during the period of study is found to be 10.15 percent compared to all states compound growth rate of 6.7 percent. Thus, it implies that growth of development

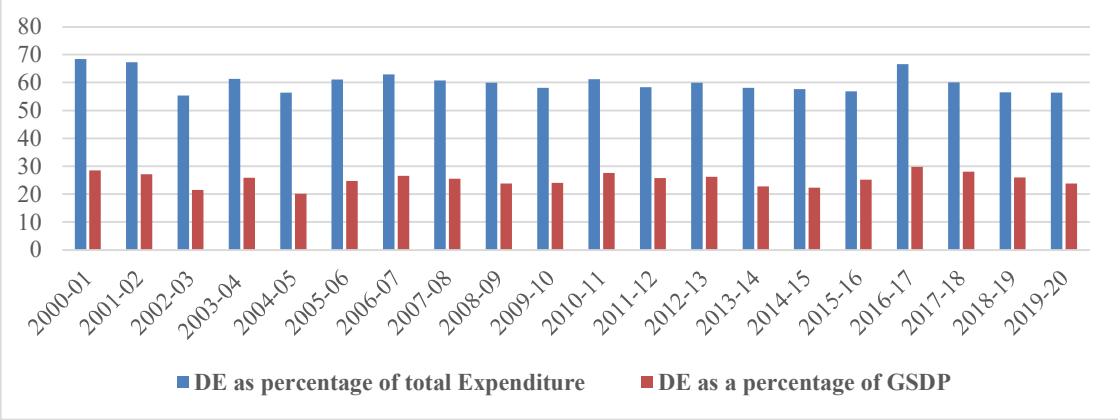
expenditure of the state is not compatible with that of all states average during the period of study.

Developmental expenditure constituted a major portion of total expenditure of the state ranging from 68.42 percent in the year 2001-02 to 56.40 percent in 2019-20. On average, the developmental expenditure has constituted 60.15 percent of the total expenditure of the state during the period of study. Compared to this, the average ratio of developmental expenditure to total expenditure of all states during the period of study is found to be 45 percent. But the average ratio development expenditure to total expenditure of the special category states is found to be greater than the state's average during the period of study.

The development expenditure has increased from Rs.1048.24 crore in 2000-01 to Rs.7248.81 crore in 2019-20. It has grown at an annual trend growth rate of 11.50 per cent and compound annual growth rate of 10.15 per cent. Ratio to GSDP has moved around 28.49 per cent up to 2000-01 with maximum 29.82 percent in 2016-17. From 2000-01 it registered a decline and moves around 24 to 25 per cent. The ratio of developmental expenditure as a ratio of GSDP, total expenditure and aggregate expenditure of the state has been shown in figure 3.6.

Figure 3.6

Development Expenditure as a percentage of GSDP, Total Expenditure and Aggregate Expenditure of the State



As evident from figure 3.6, development expenditure has maintained a stable ratio with GSDP for the time period taken for analysis. The divergence between the ratio of development expenditure to total and aggregate expenditure of the state is found to decline during the period of study.

The growth in the absolute value of development expenditure itself is not enough to explain the process of development, as population is also on the rise. As such, it is necessary to analyse the per-capita development expenditure in terms of per-capita expenditure on social services and per-capita expenditure on economic services. The classification of the developmental expenditure on a per-capita basis actually reflects the quality of expenditure (Shariff et al. 2002; Choudhury, 2002). Here, real per-capita expenditure is used. For doing this, as done in the previous chapter, the variables are converted into constant 2004-05 prices by splicing to make it comparable for the whole time period taken for the analysis. Mid-year population figures have been taken from CSO and price deflators have been computed from the ratio of current to constant price GSDP figures. The per-capita expenditure on social, economic and per-capita developmental expenditure of the state has been provided in table 3.15.

Table 3.15

Per-capita Expenditure on Social Services, Economic Services and Developmental Services

(Rs. in Crore)

Year	Per Capita Expenditure on Social Services	Per Capita Expenditure on Economic Services	Per Capita Developmental Expenditure
2000-01	98.57	130.67	5241.2
2001-02	117.72	141.9	5617.45
2002-03	168.21	183.1	5117.6
2003-04	159.25	228.73	6772.85
2004-05	170.02	207.97	5816.6
2005-06	182.69	329.34	7883.2

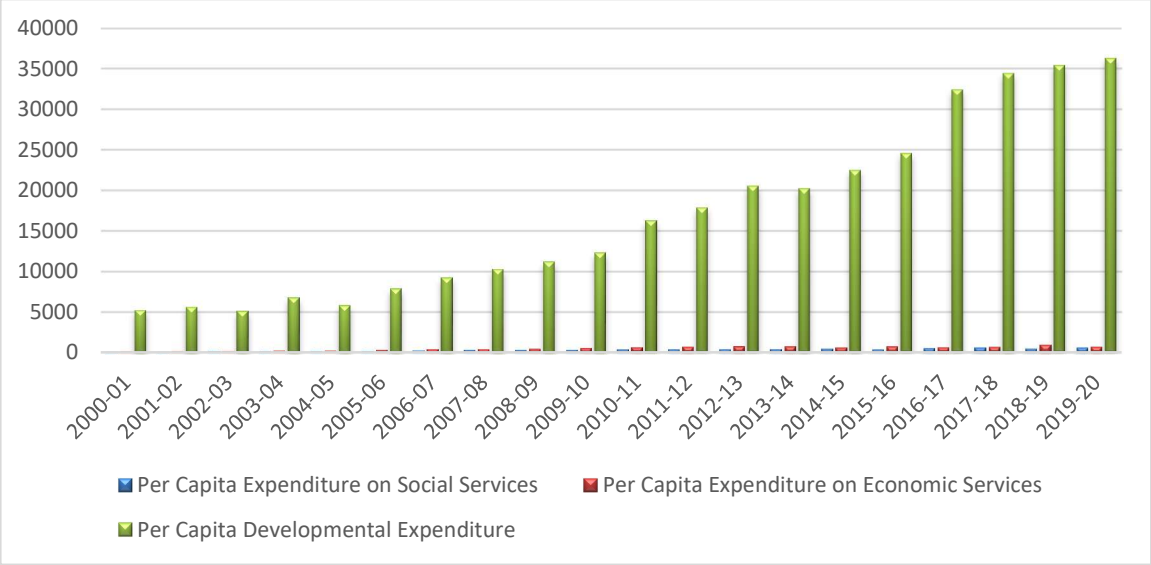
2006-07	270.42	433.02	9225.75
2007-08	323.66	429.05	10312.9
2008-09	326.63	454.36	11223.1
2009-10	323.72	555.68	12322
2010-11	362.39	660.63	16252.1
2011-12	396.47	745.02	17855.15
2012-13	419.91	777.46	20538.8
2013-14	409.57	767.2	20226.75
2014-15	443.74	599.93	22456.95
2015-16	392.19	759.21	24560.7
2016-17	546.48	634.82	32390.15
2017-18	613.63	687.72	34398.45
2018-19	487.84	983.33	35389.7
2019-20	608.52	742.47	36244.05

Source: 1. Annual Financial Statement (Budget) Actuals, Govt. of Nagaland.
2. State Finances Audit Report of the Comptroller and Auditor General of India.

It is evident from table 3.15 that per-capita developmental expenditure has increased from Rs. 5,241.2 crore in 2000-01 to Rs. 36,244.05 in 2019-20 and thus registered a compound growth rate of 10.15 percent during that period. Similarly, per-capita expenditure on economic and social services has increased from Rs. 98.57 crore and Rs. 130.67 crore in 2000-01 to Rs. 608.52 crore and Rs. 742.47 crore in 2019-20 respectively. The compound growth rate of these two components of expenditure is found to be 9.53 and 9.07 percent respectively during the above-mentioned period. During 2000s, per-capita developmental expenditure has increased from Rs. 5241.2 crore in 2000-01 to Rs. 12,322 in 2009-10 and thus registering positive compound growth rate of 8.92 percent. After that, improvement was observed in per-capita development expenditure during the second decade of the present century with a compound growth rate of 8.35 percent. This was mainly due to the improvement in the

fiscal position of the state in recent years. The improvement in the fiscal position of the state gives flexibility in investing more in developmental activities. The per-capita expenditure on social services, economic services and per-capita development expenditure of the state is also shown in figure 3.7.

Figure 3.7
Per-capita Expenditure of the State on Social Services, Economic Services and Per-capita Development Expenditure



It is evident from figure 3.7 that these three categories of expenditure have shown improvement during the time period 2000-01 to 2019-20. Per-capita expenditure on social services has been found to be lower than the per-capita expenditure on economic services during the period of study. It is evident from the above discussion that the state has experienced an increase in per-capita development expenditure in recent years. Since development expenditure is a component of total expenditure, it is also necessary to analyze the relative increase in development expenditure with respect to the increase in total and aggregate expenditure of the state. As discussed in the previous chapter, some broad conclusions can be drawn by simple tools such as annual and compound growth rate.

3.12 Regression Analysis of Impact of Total Expenditure on Developmental Expenditure

Table 3.16
Regression of Development Expenditure on Total Expenditure

Development Expenditure	Coefficient	Standard Error	t	P>|t|	
Total Expenditure	0.578089	0.013398	43.15	0.000	
Constant	88.79478	90.93033	0.98	0.342	
R^2	0.9904	Source	ss	df	ms
Adjusted R^2	0.9899	Model	88799834	1	88799834
Number of Observation	20	Residual	858529.6	18	47696.09
		Total	89658363.3	19	4718861.22

*Calculated using **STATA 17***

Based on the regression output provided, this analysis examines the relationship between Development Expenditure (dependent variable) and Total Expenditure (independent variable) using 20 observations.

Regression Equation

The estimated linear relationship can be expressed as:

Development Expenditure=88.79478+0.578089×Total Expenditure

Regression Analysis showing the strong positive relationship between Development Expenditure and Total Expenditure with $R^2 = 0.9904$

Coefficient Analysis

Total Expenditure Coefficient (0.578089)

The coefficient of 0.578089 indicates that for every unit increase in Total Expenditure, Development Expenditure increases by approximately 0.578 units, holding all other factors constant. This positive coefficient demonstrates a strong direct relationship between the two variables, suggesting that as governments increase their total spending, development expenditures rise proportionally, though not on a one-to-one basis.

Statistical Significance

With a t-statistic of 43.15 and a p-value of 0.000 ($p < 0.001$), the coefficient is highly statistically significant. This provides overwhelming evidence that Total Expenditure is a strong predictor of Development Expenditure in the sample analyzed.

Constant Term (88.79478)

The intercept of 88.79478 represents the theoretical Development Expenditure when Total Expenditure equals zero. However, with a t-statistic of 0.98 and p-value of 0.342, this constant is not statistically significant, indicating it may not differ meaningfully from zero in practical terms.

Model Fit and Explanatory Power

R-squared (0.9904)

The R-squared value of 0.9904 indicates that approximately 99.04% of the variation in Development Expenditure is explained by totally high explanatory power suggests that Total Expenditure is an excellent predictor of Development Expenditure patterns.

Adjusted R-squared (0.9899)

The Adjusted R-squared of 0.9899 confirms the robustness of the model fit, accounting for the number of predictors. The minimal difference between R^2 and Adjusted R^2 (0.0005) indicates that the model is not overfitted despite having only one predictor variable.

ANOVA Table Interpretation

The Analysis of Variance (ANOVA) breakdown reveals:

Source	Sum of Squares	Degrees of Freedom	Mean Square
Model	88,799,834	1	88,799,834
Residual	858,529.6	18	47,696.09
Total	89,658,363.3	19	4,718,861.22

The Model Sum of Squares (88,799,834) is substantially larger than the Residual Sum of Squares (858,529.6), confirming that the regression model captures most of the variation in the data.

In conclusion, the regression analysis reveals a highly significant and strong positive relationship between Development Expenditure and Total Expenditure. The model demonstrates exceptional explanatory power ($R^2 = 0.9904$) and statistical reliability, making it valuable for:

1. Budget forecasting and planning purposes
2. Understanding fiscal allocation patterns in government spending
3. Policy analysis regarding development expenditure priorities

The findings suggest that governments maintain a consistent proportional commitment to development spending as their overall expenditure increases, with approximately 57.8% of each additional spending unit directed toward development activities. This pattern indicates sound fiscal management practices that balance development priorities with other governmental responsibilities.

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CHAPTER 4
IMPACT OF REFORM ON FISCAL AND DEBT SUSTAINABILITY OF THE STATE

In the previous chapter, the pattern and composition of government expenditure has been studied to see the growth and quality of public expenditure of the state. Implication of recent fiscal reform measures on government expenditure has also been examined to know the allocation and prioritization of expenditure. Available literature states that proper allocationof resources with emphasis on developmental expenditure is the main requirement for overalldevelopment of the states (Howes et al, 2004; Dasgupta, 2012). The state needs sufficient amount of revenue to discharge those expenditure responsibilities. Otherwise, there will be imbalances between total resources of the government and their expenditure obligations. Under these circumstances, it is pertinent to study whether total receipts of the state government are sufficient to meet the expenditure responsibilities of the government. Available literature on this issue opines that while revenue receipts of the governments should be adequate to meet the revenue expenditure, capital expenditure could be incurred out of the borrowed funds (Srivastava, 2009; Rao, 2002; Lahiri, 2000). The above two rules are basically influenced by the Maastricht Treaty and U.K. Golden rule. The Maastricht Treaty which was signed in February 1992 by the members of the European community in Maastricht, Netherlands stated that country's overall budget deficit for each fiscal year must be equal to or below 3 percent of GDP. The U.K. has been operating a Golden rule since1997 whereby borrowing should be made only to finance capital spending. Fiscal imbalancesof a state generally occur mainly due to excessive growth of expenditure and inability of the state government to meet that expenditure out of their revenue and capital receipts. The theoretical underpinning of the budget deficit lies in the fact that until the Keynesian revolution (Keynes, 1936), budget deficits were considered as signs of profligacy. Governments were often forced to incur large deficits in times of war or

natural calamities; but the prudent ones used to pay off debt by running surplus budget when normalcy had returned (Rajaraman and Mukhopadhyay, 2005). With the advent of Keynesian economics, budget deficit was even considered essential for macro stabilization. Counter-cyclical fiscal policies require the government to run budget deficits in times of demand deficiency and fiscal squeeze during booms. If the business cycle is symmetrical around the economy's full employment growth path, such policies help to keep the budget balance over a typical cycle and there is no tendency for a secular increase in public debt. But if the budget deficit is chronic instead of cyclical, then resulting accumulation of debt makes the budgetary process unsustainable. Debt financing is problematic in the demand deficient economy when the deficiency is chronic or structural rather than cyclical (Rakshit, 2005).

There is a growing awareness among the states in India in recent decades to contain fiscal imbalances which has led to accumulation of debt and deterioration in the fiscal indicators (Rao, 2002; Srivastava, 2009). Earlier, most Indian economists were of the view that the growth of public debt in planned magnitude was normal and desirable in a developing country like India where borrowing represents the absorption by the government of a part of domestic savings and the inflow of capital from abroad to finance and promote capital formation in the public sector and priority areas in the private sector (Chelliah, 1996). But this view was based on the assumption that borrowed funds would be used only for capital purposes and the resultant investment would yield adequate direct and indirect returns. But these assumptions were not often fulfilled in case of both central and state governments in India. The fiscal crisis and the resultant exponential growth of public debt in India in laterpart of 1990s was not merely because of rising revenue expenditure ahead of current revenues, but also because capital expenditure financed by borrowings did not yield adequate returns (Chelliah, 1996). The deterioration in the fiscal indicators and rising public debt of the state governments in India during that period disrupted the normal functioning of the economy (Rao, 2005). Deterioration in the fiscal indicators of the state governments contributed towards macroeconomic instability of the whole nation. Considering that

fact, therecent Finance Commissions of Government of India in their terms of reference have given importance on fiscal and debt sustainability (TFC, 2009). A sustainable fiscal policy helps a state to maintain a stable fiscal position without undertaking drastic and painful reforms measures. The significance of fiscal sustainability is more for poor and backward states as deterioration in their fiscal position may hamper the overall economic development of those states.

Radhika et al, 2004 observed that while States are allowed to raise both tax and non-tax revenue for financing their activities, they can also raise funds from markets to meet any shortfall between revenue and expenditures. In India, both the Central Government and State Governments raise funds through fixed income securities or bonds. The Central Government can raise two kinds of bonds, short-term (also known as Treasury Bills (T-Bills), with maturities less than one year) and long-term duration (also called Government Securities (G-Secs), with maturities above one year). State Governments, on the other hand, only raise what are known as the State Development Loans (SDLs) (recently renamed as SGS, or State Government Securities). Both Central and State Government Securities are considered to be risk-free, marketable securities, which are backed by the fiscal authority of the sovereign.

Bhattacharya et al, 2024 found that conceptually, higher government expenditure funded by government borrowing may boost growth rate, initially via fiscal multiplier and crowding in effects and thereby yield a rise in primary surplus. However, beyond an optimal level of borrowing, an additional increase in public debt may reduce investment due to crowding out, debt overhang and uncertainty.

Chakraborty, 2024 states that “High deficits are substantiated if they are significantly used for public infrastructure investment.” The Special Category states receive special financial assistance and other benefits from the central government due to their unique developmental needs and challenges. The SCS is determined based on five factors: hilly terrain, low population density or sizeable tribal population, strategic location along borders, economic and infrastructure backwardness, and non-viable state finances. These determinants are based on the Gadgil formula of fiscal transfers. Currently, 11

states enjoy SCS status: Jammu and Kashmir (now a Union Territory), Assam, Nagaland, Himachal Pradesh, Manipur, Meghalaya, Sikkim, Tripura, Arunachal Pradesh, Mizoram, and Uttarakhand.

Chakraborty et al, 2017 also found that an analysis of the debt and deficit of states based on the budget estimates of 2016–17 shows that almost half of them have a fiscal deficit target higher than the limit set in the Fiscal Responsibility and Budget Management Act. These states need to focus on the quality of expenditure and elimination of revenue deficit as per the framework proposed by the Fourteenth Finance Commission to enhance state-level capital spending.

As Nagaland is a poor state with lots of deficiencies particularly in the infrastructure sector, it is necessary to study the sustainability of the fiscal position of the state. Considering the significance of fiscal and debt sustainability on state finances, the issue of fiscal and debt sustainability of the state has been carried out in this chapter.

4.1 Theoretical Framework for Examining Fiscal and Debt Sustainability

The issue of fiscal sustainability and solvency is usually addressed by analyzing the variables such as growth rate of GSDP, average interest rate on public debt and growth rate of public debt etc. The concept of solvency and sustainability are closely related in the sense that an unsustainable time path will ultimately threaten the solvency of a state (Rajaraman et al., 2005). The earlier statement of debt dynamics by Domar (1944) remains the simplest guide for the policy maker for fiscal and debt sustainability which states that "If the government finances a part of the expenditure (amounting to a given fraction of full employment output) through borrowings, in a growing economy, public debt and the government interest outgo asa proportion of GDP will be stable in the long run provided that growth rate exceeds the interest rate." Subsequent restatements in terms of infinite horizon constraint on the present discounted value (PDV) of debt have not changed the fundamental Domar condition for stabilization of debt as a ratio to GDP (Rajaraman, 2005; Rakshit, 2005; Rath, 2005). The fiscal and debt sustainability of the state have been analysed with the help of the following equations as provided below.

According to Domar's model for solvency of public debt,

$$D_0 = -\sum \frac{PD_t}{(1+r)^t} \quad \text{..... (i)}$$

Here, D_0 = Present stock of outstanding debt

PD_t = Primary deficit for the time period **t**

r = interest rate on public debt

The above equation implies that for solvency, the present outstanding stock of public debt must be equal to the summation of discounted primary surplus of future years expressed in termsof present value. Primary deficit incurred in a particular year can be expressed as,

$$PD_t = D_t - (1+r)\, D_{t-1} \text{ .....(ii)}$$

Equation **(ii)** simply states that primary deficit plus interest on past debt (rD_{t-1}) has to be financed by a built-up debt itself $(D_t - D_{t-1})$ (Lahiri and Kannon, 2004).

Now, equation **(i)** can be rewritten by replacing the value of PD_t as obtained from equation **(ii)**

$$D_0 = -\sum \frac{D_t - (1+r)D_{t-1}}{(1+r)^t} \quad \text{..... (iii)}$$

Let us, consider that the variable D_t is growing at the rate of **k**, so that

$$D_t = (1+k)\, D_{t-1}$$

Replacing the value of D_t in equation **(iii)**

$$\Rightarrow D_0 = -\sum \frac{(1+k)\, D_{t-1} - (1+r)D_{t-1}}{(1+r)^t}$$

$$\Rightarrow D_0 = -\sum \frac{(k-r)D_{t-1}}{(1+r)^t}$$

$$\Rightarrow D_0 = (r-k)\sum \frac{D_{t-1}}{(1+r)} \quad \ldots\ldots\ldots\ldots\ldots\ldots \text{(iv)}$$

$$\Rightarrow D_0 = (r-k)\sum \frac{(1+k)^{t-1}D_0}{(1+r)^t}$$

$$\Rightarrow D_0 = \frac{(r-k)}{(1+r)} \sum \left[\frac{(1+k)}{(1+r)}\right]^{t-1} D_0 \ldots\ldots\ldots \text{(v)}$$

$$\Rightarrow D_0 = 0 \text{ if } r = k \ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{(vi)}$$

The above equation implies that for solvency of public debt, the interest rate on public debt must be equal to growth rate of public debt. Apart from solvency, it is also necessary to examine the conditions for sustainability of public debt.

Another Alternative formula for the Domar model is;

$$\frac{\Delta D}{Y} = \frac{(r-g)D}{Y} + \frac{G-T}{Y}$$

Where:

- **ΔD/Y** : Change in the debt-to-GSDP ratio over time
- **r** : Interest rate on government debt
- **g** : Growth rate of GSDP
- **D** : Level of government debt
- **Y** : GSDP
- **G – T** : The primary budget deficit (Government spending **G** minus tax revenues **T**)

Key Insights:

1. If the growth rate of GSDP g is higher than the interest rate r (i.e., g > r), the debt-to-GSDP ratio will tend to decrease over time, even if there is a primary deficit.
2. If r > g, the debt-to-GSDP ratio will increase unless there is a primary surplus.
3. The model shows that a state/country can run a small primary deficit (spending more than it earns) as long as economic growth outpaces the interest rate on debt.

In summary, solvency in the Domar model depends on the relationship between the interest rate on debt and the economic growth rate, as well as the size of the primary budget deficit.

The above theoretical framework provides an idea about the crucial variables and their relationship which are used for studying the fiscal and debt sustainability of the state. It is found from the above discussion that deficit indicators have a significant impact on the sustainability of fiscal position of a state. The next section of the chapter is carried out to examine fiscal sustainability of the state with the help of the deficit indicators.

4.1.2 Debt sustainability of Nagaland as per the Domar model

The debt Sustainability of the Government of Nagaland is assessed in terms of the Domar model for 10 years in Table 4.1, where the sustainability of debt is based on the relationship between the key fiscal values - public debt, growth rate, interest rate and primary balance. As per this model, for debt to be sustainable, the rate of interest payable on the outstanding debt should be lower than the rate of growth of GSDP (Domar gap); and there should be a primary surplus. Debt sustainability of Government of Nagaland is given below as per the Domar model.

Table 4.1
Debt sustainability as per the Domar model

Year	Growth Rate of GSDP (g)	Average Interest Rate (r)	g-r	Primary Deficit/ Surplus (s) (Rs. in crore)	Remarks
2010-11	10.48	8.07	2.41	81.73	As g-r>0 and s>0, public debt will converge to a stable level less than zero leading to public savings
2011-12	0.68	5.52	(-) 4.84	(-) 121.59	As g-r<0 and s<0, public debt will increase indefinitely, without converging to a stable level
2012-13	13.07	7.38	5.69	(-) 202.95	As g-r >0 and s<0, public debt will converge to a stable level
2013-14	18.02	8.75	9.27	34.43	As g-r>0 and s>0, public debt will converge to a stable level less than zero leading to public savings
2014-15	10.77	6.81	3.96	421.22	As g-r>0 and s>0, public debt will converge to a stable level less than zero leading to public savings
2015-16	6.10	6.95	(-) 0.85	(-) 10.82	As g-r<0 and s<0, public debt will increase indefinitely, without converging to a stable level
2016-17	11.26	6.87	4.39	350.64	As g-r>0 and s>0, public debt will converge to a stable level less than zero leading to public savings
2017-18	11.78	6.79	4.99	231.66	As g-r>0 and s>0, public debt will converge to a stable level less than zero leading to public savings
2018-19	9.70	7.00	2.70	(-) 310.58	As g-r >0 and s<0, public debt will converge to a stable level
2019-20	11.34	8.02	3.32	(-) 614.48	As g-r >0 and s<0, public debt will converge to a stable level

Source: State Finances, Audit Report of the Comptroller and Auditor General of India (C&AG)

The positive Domar gap is, however, combined with a primary deficit in 2018-19 and 2019-20. This related with the indicator analysis above as well as the fiscal consolidation roadmap recommended by the XIV FC, while indicating debt sustainability, warrant caution by the Government of Nagaland regarding its debt.

4.2 FISCAL DEFICIT MANAGEMENT

Revenue deficit and capital deficit represent the excess of expenditure over the receipts under the revenue and capital accounts respectively. The conventional budget deficit is the algebraic sum of the revenue and capital deficits, but this does not actually show the total resource gap in the economy, as it includes borrowings under the capital receipts (Bhattacharjee, 2016). The overall resource gap is reflected by the Gross Fiscal Deficit (GFD) which is bridged by borrowings of one sort or another. Gross fiscal deficit is composed of the revenue deficit, capital outlay, and net lending made by the Government; it is financed by net borrowings under the Consolidated Fund, net borrowings under the Public Account, and also by drawing down the cash balance that the state governments maintain with the Reserve Bank of India.

The indicators used for measuring deficit management by states and the results are shown in table 4.2 below for Special Category States of India. From the table it can be seen that in 2000-01, almost all special category states were running very high level of fiscal deficits; only Uttarakhand and Assam had somewhat manageable fiscal deficits. For all other states, the fiscal deficits had reached dangerous levels which clearly were unsustainable. Mizoram's fiscal deficit amounted to 21.6 per cent of its GSDP, followed by Himachal Pradesh (11.8 per cent), Jammu and Kashmir (11.2 per cent), Arunachal Pradesh (9.9 per cent), Nagaland (8.5 per cent) and Tripura (8.0 per cent). All these states were also having high levels of deficit in their primary accounts. Only three states – Sikkim, Arunachal Pradesh and Meghalaya were – able to generate surpluses in their revenue accounts and hence could increase their capital outlays significantly; the

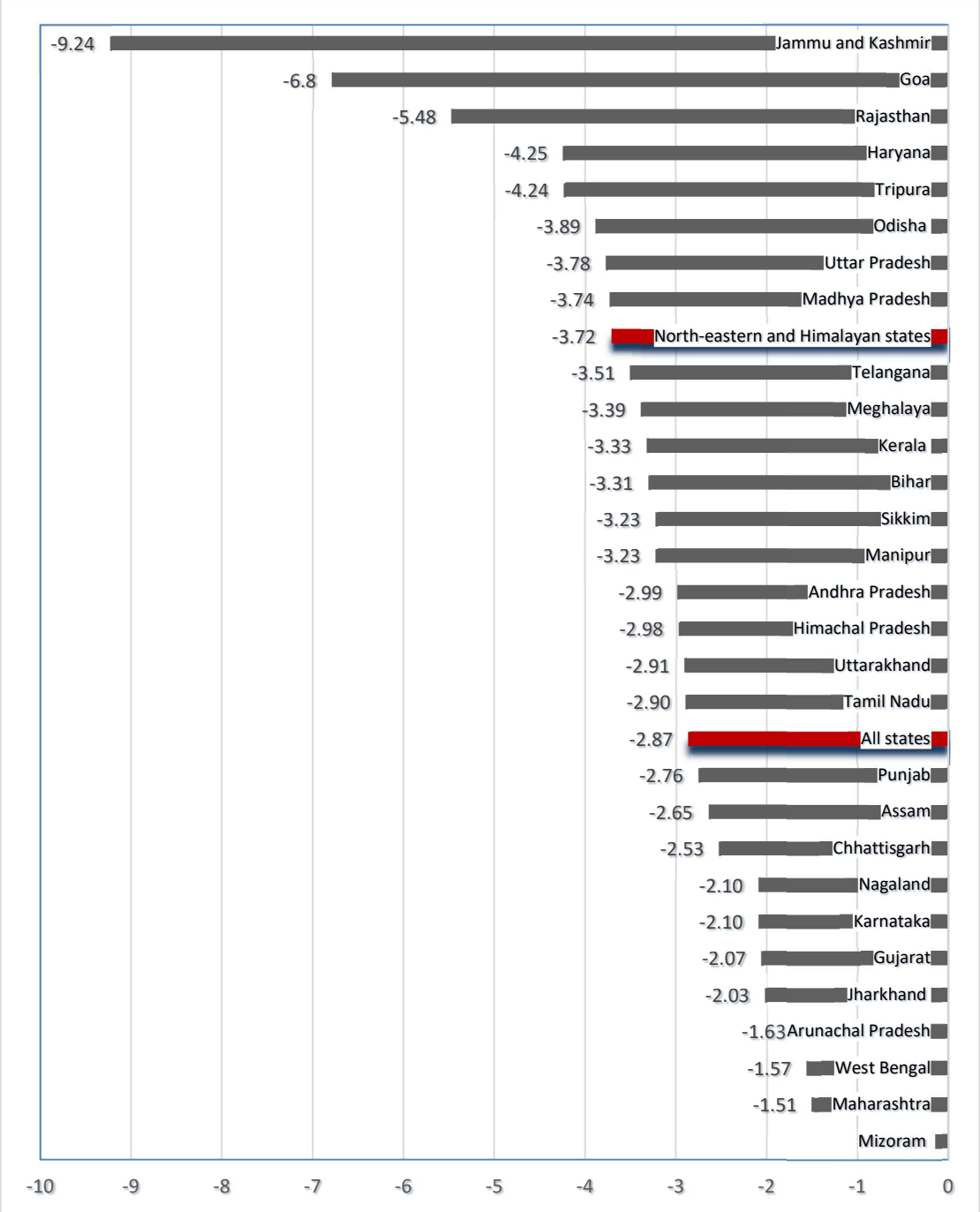
revenue accounts of all other states were in deficits. The revenue deficits of as many as five states contributed to more than 50 per cent of their fiscal deficits. It was a sure recipe for impending disaster. But they were saved from this disaster by the XII FC, which forced the states to curtail their revenue expenditure by enacting FRBMAs. In 2010-11, i.e., after the end of the XII FC period, only two states (Himachal Pradesh and Mizoram) had deficits in their revenue accounts, Uttarakhand had a balanced revenue account and rest all were generating surpluses, six of them very substantially, which surpluses they could use for making capital outlay and limit borrowing to that extent. Fiscal deficits of the five states were within the FRBMA norm of 3 per cent of GSDP. Finances of most of the states were back on track (Bhattacharjee, 2016). Nagaland's GFD/GSDP was at 4.8 per cent during 2010-11.

Table 4.2
Deficit Indicators of Special Category States:2000-01 and 2010-11

Deficit Ratios (Per cent)	Arunachal Pradesh	Assam	Himachal Pradesh	Jammu & Kashmir	Manipur	Meghalaya	Mizoram	Nagaland	Sikkim	Tripura	Uttara khand
2000-01											
Revenue Deficit to GFD	-46	51	70	51	35	-21	51	30	-119	20	54
Capital Outlay to GFD	144	36	30	46	65	91	44	71	290	79	34
Net Lending to GFD	1	13	1	2	0	31	5	-1	0	0	12
GFD/GSDP (Per cent)	9.9	4.2	11.8	11.2	7.3	6.3	21.6	8.5	5.1	8.0	3.9
Primary Deficit/ GSDP (per cent)	4.8	1.8	6.7	6.6	1.6	3.4	15.8	3.4	-2.7	3.9	0.7
2010-11											
Revenue Deficit to GFD	-	-	39	-	-	-	39	-	-	-	1
Capital Outlay to GFD	-	101	56	256	337	168	16	231	143	464	101
Net Lending to GFD	-	2	5	3	0	4	0	0	2	-1	-1
GFD/GSDP (Per cent)	-0.3	1.8	5.6	4.2	6.2	2.3	16.8	4.8	5.6	1.3	2.2
Primary Deficit/ GSDP (per cent)	-4.9	0.1	2.2	0.1	2.2	0.6	15.1	1.1	2.3	-1.2	0.4

Source: Bhattacharjee, Govind, 'Special Category States of India' (Delhi, 2016) and State Finances, Audit Report of the Comptroller and Auditor General of India (C&AG) of SCS (Different issues)

Figure 4.1
Fiscal Deficit in 2016–17 BE (% of GSDP)



Source: 2016–17 Budget Documents of State Governments and CSO, Government of India.

From the figure 4.1 above of fiscal deficit during 2016–17, all states' combined deficit is expected to be below 3 percent of GSDP as mandated under the Fiscal Responsibility and Budget Management (FRBM) Act. However, 14 states have budgeted to show fiscal deficits above 3 percent of GSDP. States budgeted to have a fiscal deficit of more than 4 percent of GSDP are Tripura, Haryana, Rajasthan, Goa, and Jammu and Kashmir. Nagaland had a fiscal deficit of 2.10 percent of GSDP.

4.2.2 Fiscal Sustainability of the State

Fiscal sustainability is a concept that refers to the ability of a government to sustain its current spending, tax and other policies in the long run without threatening government solvency or defaulting some of its liabilities or promised expenditures. There is no precise or exact definition of fiscal sustainability (Chalk and Hemming, 2000). The trend and composition of the deficit indicators provide vital inputs towards sustainability status of a government. The deterioration of the fiscal indicators may push the state into a deep fiscal crisis which ultimately may lead to the overall deterioration of the state 's economy. Considering the above fact, sustainability of fiscal position of the state government has been carried out with the help of those deficit indicators. Deficits are customarily categorized as revenue deficit, fiscal deficit and primary deficit.

4.3 Trend and Pattern of Revenue Deficit in Nagaland

Revenue deficit is excess of revenue expenditure of the government over revenue receipts. It represents dis-saving of a government and shift to present consumption. The revenue deficit has an adverse impact on the capital formation of the government and as such considered as the most undesirable of all such deficits. Revenue deficit also does not have any asset backup as it is incurred to meet the current expenditure. The revenue deficit incurred by the state governments over the study period has been given in table 4.3.

Table 4.3
Revenue deficits

(Rs. in crore)

Year	Revenue Receipt	Revenue Expenditure	Revenue Deficit	Revenue Deficit/ Surplus as a % of GSDP
2000-01	1254.1	1290.23	-36.13	-0.98
2001-02	1324.53	1427.11	-102.58	-2.48
2002-03	1346.90	1506.27	-159.37	-3.36
2003-04	2359.79	1812.99	546.8	10.44
2004-05	1839.52	1684.63	154.89	2.68
2005-06	2267.20	2060.53	206.67	3.24
2006-07	2772.51	2222.15	550.36	7.91
2007-08	2996.02	2572.27	423.75	5.25
2008-09	3400.89	2889.54	511.35	5.42
2009-10	3719.76	3252.44	467.32	4.55
2010-11	4999.99	4187.84	812.15	6.91
2011-12	5586.38	4875.66	710.72	5.13
2012-13	6204.29	5601.39	602.9	3.85
2013-14	6497.90	5750.35	747.55	4.21
2014-15	7650.94	6762.41	888.53	4.42
2015-16	8043.57	7581.92	461.65	2.36
2016-17	9442.28	8641.94	800.34	3.68
2017-18	11019.21	10191.35	827.86	3.38
2018-19	11437.41	10919.98	517.43	1.90
2019-20	11,423.29	12843.34	-1420.1	-4.65

Source: State Finances, Audit Report of the Comptroller and Auditor General of India (C&AG)

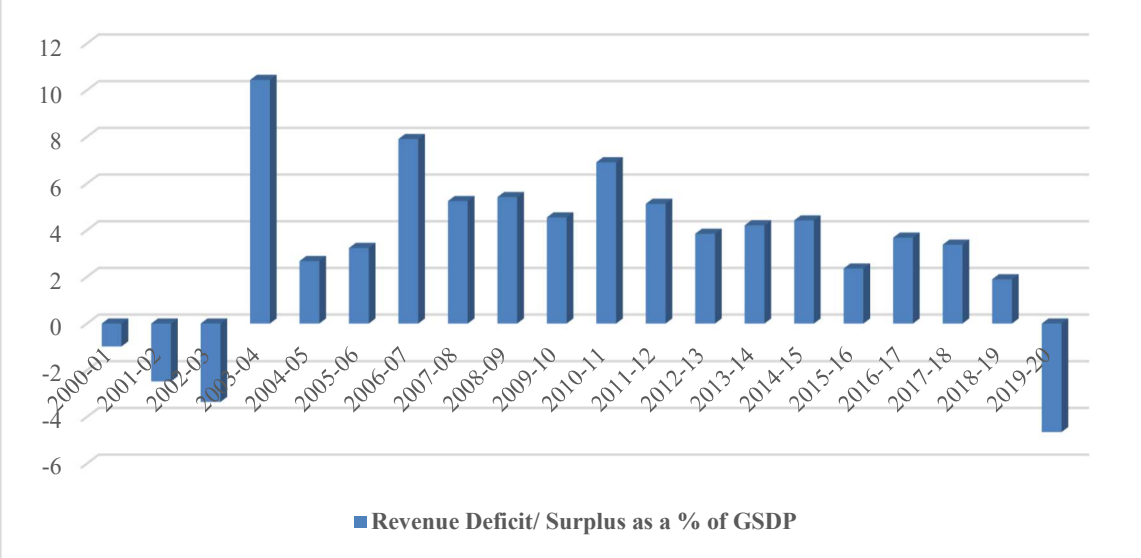
It is evident from table 4.3 that the state has been experiencing fluctuations in revenue deficit during the period under study. During the first half of the 2000s, the state experienced revenue deficit in the year 2000-01 to 2002-03 then the state experienced a huge revenue surplus amounting to Rs. 546.8 crore in the year 2003-04. In the year 2014-15 the Revenue Surplus had a record high of Rs. 888.53 crore but reduced in the next year and continued with an increasing trend. But in the year 2019-20, the state experienced an increase in revenue expenditure of 14.98 percent compared to the increase in revenue receipt of - 0.12 percent. In fact, the state incurred a huge revenue deficit of Rs. 1420.1 crore (- 4.65 percent of GSDP). The growth rate of revenue

expenditure throughout the study period was found to increase in subsequent years. But the amount of revenue expenditure remained greater than revenue receipt during the years 2000-01 to 2002-03 and 2019-20. As discussed in the previous chapter, the principal factors responsible for the burgeoning revenue expenditure in that period were the relentless increase in expenditure on salaries, wages and pension, known as committed expenditure and growing debt servicing obligations on account of a significant increase in borrowings mostly to meet revenue expenditure requirements. The increase in revenue expenditure on salaries and wages was mainly due to implementation of the new payscale in line with the recommendations of the Fifth and Sixth Central Pay Commissions which imposed an additional fiscal burden on the state government. Moreover, high level of financial support to Public Sector Undertakings necessitated by their inability to meet their obligations led to increase in revenue expenditure during that period.

The continuing imbalances between revenue receipt and expenditure had a severe fall out on the cash flows of the state government, compelling it to rely heavily on the ways and means and overdraft facility indicating greater and greater reliance on high-cost bank finance. With the state government taking the overdraft repeatedly, payments on the state government's account were suspended by the Reserve Bank of India. The state government was on overdraft for extended periods in multiple years. For example, in 2000–01, Nagaland had an overdraft of ₹34.50 crore from the RBI. While exact day counts for each year aren't consistently published, audit reports from the Comptroller and Auditor General (CAG) indicate that Nagaland breached the permissible overdraft duration multiple times, especially in the early 2000s and mid-2010s. Consequently, payments of salaries and pensions have often been delayed. But during 2003-04 to 2018-19, the state was able earn revenue surplus for consecutive years. It was found that the fall in the relative growth of revenue expenditure compared to revenue receipts contributed towards improvement in the revenue position of the state. The growth rate of revenue receipts remained higher than the revenue expenditure during the time period

2003-04 to 2018-19. But in the year 2019-20, the state again incurred a huge revenue deficit of Rs. 14.201 crore which constitute 4.65 percent of GSDP. This was mainly due to high growth of revenue expenditure amounting to 14.94 percent compared to the growth rate of revenue receipt, which was found to be only -0.12 percent. Such a high increase in revenue expenditure was mainly contributed by the implementation of the Nagaland Pay Commission's (2017) recommendations. The implementation of the 7th Pay Commission recommendations by the Government of Nagaland led to a significant increase in the state's fiscal expenditure. In the fiscal year 2018–19, there was an 18.99% increase in revenue expenditure over the previous year, primarily attributed to the revision of salaries as per the 7th Pay Commission, the release of dearness allowances, and incremental benefits. This surge in expenditure resulted in 43.23% of the Revenue Receipts and 45.28% of Revenue Expenditure being allocated towards the disbursement of salaries and wages during that year. The time series data on revenue deficit as a percentage of GSDP of the state over the years is also shown in figure 4.2.

Figure 4.2
Revenue Deficit as Percentage of GSDP of the State



It is evident from figure 4.1 that the state has been incurring revenue deficit in some years during the period of study. The recent increase in revenue deficit in the year 2019-20 implies that the state government violated the norms of Nagaland Fiscal

Responsibility and Budget Management Act on revenue deficit in the year 2019-20. It may have serious implication for Nagaland in terms of an increase in fiscal deficit which in turn may increase the debt to GSDP ratio the state.

4.4 Composition and Trend of Fiscal Deficit in Nagaland

Fiscal deficit is defined as the excess of aggregate expenditure over non-debt receipt. It, therefore, represents net incremental liabilities of the government. The Reserve Bank of India worked out fiscal deficit as –

Gross Fiscal Deficit = Total expenditure (Revenue + Capital + Loans and Advances) – Revenue Receipt- Non-Debt Creating Capital Receipt-Recovery of Loans and Advances

Fiscal deficit results in the creation of fiscal liabilities which makes the issue of debt sustainability critically dependent on fiscal deficit and application of resources so arranged. The rising fiscal deficit may lead to an increase in debt-GSDP ratio. Increasing debt and resultant interest payments reduces the flexibility of the governments in the matter of expenditure and also increases its committed obligations. This is due to the fact that the debt stock is added to by the fiscal deficit incurred every year. Again, even if debt financing is sustainable, large interest payments on public debt stand in the way of provision of essential public goods and rising developmental expenditure. The expenditure on interest payments of the state constituted, on average, 12.72 percent of the total revenue expenditure during 2000s. Although it has declined in recent years, but still interest payments constitute 10.29 percent of the total revenue expenditure of the state during the year period of study (CAG reports). Larger fiscal deficit and resultant increase in public debt and interest payments may compel the state to play ponzi game of borrowing more for repayments of past debt. So, the nature of the fiscal deficit is an indicator of the prudence of fiscal management of the government. Further, the ways deficit is financed; the resources raised and applied are the important pointers to its fiscal health. These borrowings incurred to meet the fiscal deficit are applied for meeting the revenue deficit, for making the capital expenditure and for giving loans to various

developmental and other purposes. The composition of the gross fiscal deficit in terms of the above-mentioned components have an implication for fiscal stability of the state. The use of borrowed funds for revenue deficit is not considered as an ideal fiscal policy for a government. On the other hand, the higher share of capital outlay and loans and advances in total fiscal deficit of the state is expected to increase the repayment capacity of the economy (Rajaraman, 2005). The fiscal deficit of the Government of Nagaland in terms of revenue deficit, capital outlay and net lending has been provided in table 4.4.

Table 4.4
Amount and Composition of Gross Fiscal Deficit in Nagaland during 2000-2020

(Rs. in crore)

Year	Fiscal Deficit	Revenue Deficit	Capital Outlay	Net Lending
		As a percentage of fiscal deficit		
2000-01	-271.43	-36.13	224.4	10.9
2001-02	-336.96	-102.58	238.73	-4.35
2002-03	-494.97	-159.37	340.69	-5.09
2003-04	157.4	546.8	391.13	-1.73
2004-05	-218	155	379	-6
2005-06	-306	207	518	-5
2006-07	-156	550	710	-4
2007-08	-397	424	821	0
2008-09	-341	511	853	-1
2009-10	-522	467	990	-1
2010-11	-313	-812	1123	2
2011-12	-539	-711	1249	1
2012-13	-654	-603	1255	2
2013-14	-459	-748	1207	0
2014-15	-134.12	888.53	-1023.17	0.52
2015-16	-159.27	461.65	-1059.23	0.31
2016-17	-284.86	790.34	-1076.1	0.9
2017-18	-446.09	827.86	-1274.85	0.9
2018-19	-1082.32	517.43	-1595.56	-4.96
2019-20	-1428.22	-213.73	-1206.32	-8.17

Source: State Finances, Audit Report of the Comptroller and Auditor General of India (C&AG)

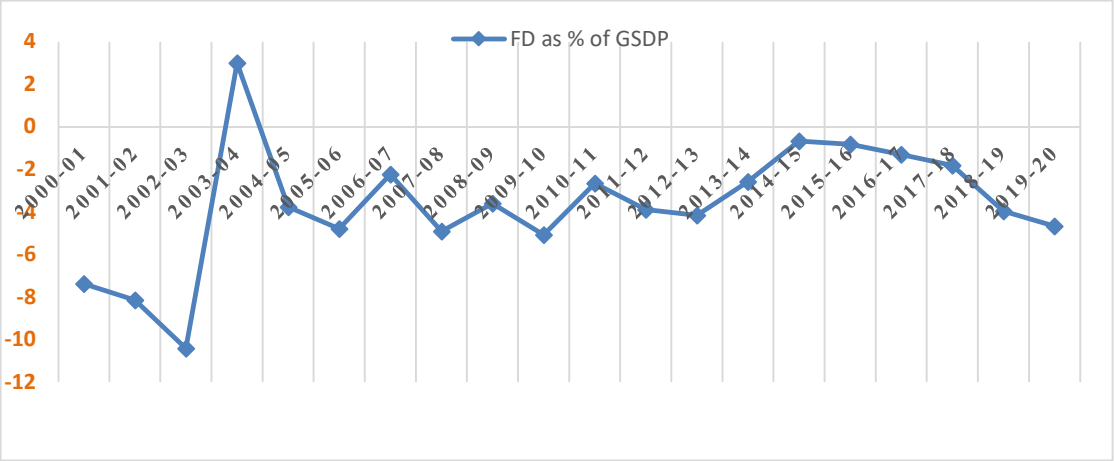
*Net lending is equal to disbursement of loans and advances by the government minus recovery of loans and advances.

It is evident from table 4.4 that the state has been experiencing the problem of fluctuations of fiscal deficit in recent decades. The composition of fiscal deficit reveals that during first half of the 2000s, the state experienced revenue surplus in one year only in 2003-04 to meet some portion of the capital outlay and for extending loans for developmental purposes. This was mainly due to the revenue surplus of Rs. 546.8 crore. The revenue surplus was impacted by a one-time grant-in-aid of Rs. 365 crore, which was included in the state's revenue. This grant-in-aid significantly influenced the state's finances for that period.

The grants from Central Government rose from Rs. 1072.14 crore in the year 2000-01 to Rs. 2978.87 crore in the year 2009-10 and thus registered an increase of 177.89 % percent. In the second half of the study period grants-in -aid rose from Rs. 3900.07 crore in the year 2009-10 to Rs. 6858.69 crore in the year 2019-20 and thus registered an increase of 75.86 % percent. The state experienced a moderate fiscal deficit of Rs. 494.97 crore (10.42 percent of GSDP) in the year 2002-03.However, in the year 2003-04 the state earned a fiscal surplus of Rs. 157.4 crore due to one-time grant-in aid from the central government as stated earlier. The trend of moderate fiscal deficit or surplus continued up to the year 2009-10 when the state experienced fiscal surplus from the year 2010-11 to 2013-14. Since then, the fiscal deficit of the state was found to increase at an unprecedented proportion mainly due to the increase in revenue deficit. During the period, 2010-11 to 2013-14 major Capital Outlays were made by the Government for infrastructure projects. To bring stability to the fiscal position of the state, the Government of Nagaland adopted lots of reform measures which resulted in improvement in the fiscal position of the state. This was evident from the fact that the state had experienced fiscal surplus in the year 2003-04 and 2010-11 to 2013-14. But, in the years 2018-19 and 2019-20, the state again incurred huge fiscal deficit mainly due to the implementation of the Nagaland Pay Commission recommendation. The implementation of the recommendations imposed an additional fiscal burden as discussed in the previous sub-section. In fact, the fiscal deficit of the state in the year

2019-20 is found to be the highest among all the years taken for the analysis. This may create a huge future fiscal burden for the Government of Nagaland in terms of the increase in borrowings of the government. The fiscal deficit as a percentage of GSDP of the state over the study period is also shown in figure 4.3.

Figure 4.3
Fiscal Deficit as a percent of GSDP of the State



It is evident from figure 4.3 that the state has been incurring fiscal deficits for most of the years during the period of study. The state is found to violate the target of Nagaland Fiscal Responsibility and Budget Management Act on Fiscal Deficit in year 2007-08 for the first time after the introduction of the Act in 2005. The fiscal deficit incurred by the state governmentin the year 2009-10 is found to be greater than the revised target on fiscal deficit of the state as set by the above Act. The state could not achieve the fiscal deficit target of 4 per cent of GSDP as prescribed in the Nagaland FRBM Act, 2005 for the year 2019-20. Under these circumstances, it is necessary to examine the financing pattern of such huge fiscal deficit of the state.

4.5 Financing Pattern of Gross Fiscal Deficit

While the composition of gross fiscal deficit assumes significance, it is also equally important to analyse the source of financing of the gross fiscal deficit. It has two

implicationsfor a state. First, it helps a state to make development plans in advance. Unless there is certainty about the availability of funds, it is not possible for a state to make developmental plans. This issue becomes very relevant particularly after the recommendations of the Twelfth Finance Commission which states that the Planning Commission should not provide loans to the state governments. After this recommendation, the center's intermediation in state debt is being discontinued. States have been asked to raise subscriptions of their loans from the market itself (Srivastava, 2009). This recommendation has implications for a poor state like Nagaland with low credibility in the loan market. The second important factor relevant in this aspect is the issue of interest payments. The interest rates are different for various sources of financing which ultimately determine the total interest obligations of the state. The different sources of financing the gross fiscal deficit of the state have been provided in Table 4.5. The amounts shown under each source of borrowing are the net of outflows or disbursement during that year.

It is evident from table 4.5 that market borrowings were the main source of financing the gross fiscal deficit of the state during the study period. The share of the net loans provided bythe central government has declined during the period of study which is found to be replaced by market borrowing. The decline in the share of central government's loans was mainly due to the declaration of the state as a special category state which helped it to acquire more planassistance in the form of grants which were earlier provided as loans (Srivastava et al., 1999).The automatic entitlement of states to loans against small savings is also found to be responsible for the declining share of central loans (Rajaraman et al., 2005). With the change in the accounting system with effect from 1999-2000, states' share in small savings which was earlier included under loans from the Centre was included under internal debt and shownas special securities issued to National Small Savings Fund (NSSF) of the Central Government (RBI, 2011).

Table 4.5
Financing Pattern of Gross Fiscal Deficit (GFD) or Surplus (GFS) of the State

Year	Market Borrowings	Loans from GoI	Special Securities issued to NSSF	Loans from Fin. Institutes	Small Savings, PF, etc.	Deposits and Advances	Suspense and Miscl.	Remittances	Reserve Fund	Others	Overall Deficit/ Surplus	Increase/ Decrease in cash balance	Gross Fiscal Deficit	Gross Fiscal Surplus
2000-01	100.62	29.05	0	-10.5	32.02	4.52	0	-12.01	0.66	64.8		23.71	**271.43**	
2001-02	210.27	22.09	0	109.82	32.02	-11.62	40.08	-12.63	-1.52	78.33		45.86	**336.96**	
2002-03	167.5	422.76	0	-11.58	18.54	79.68	162.79	-61.54	0.96	172.4	(-)159.37	111.64	**494.97**	
2003-04	286.32	-508.81	0	44.93	21.62	-18.4	202.87	14.71	-1.88	0	(-)127.66	(-)333.19		**157.4**
2004-05	139	40	11	39	11	42	(-)20	(-)46	0	4	2	-15.07	**218**	
2005-06	214	-14	11	97	4	-46	-27	-32	0	106	7	84.31	**306**	
2006-07	250	-17	15	56	-7	92	-60	-78	0	-44	51	-81.12	**156**	
2007-08	297	-15	0	52	13	75	-58	-42	0	-91	(-)166	-86.91	**397**	
2008-09	373	-22	-2	96	30	214	-189	-126	0	0	33	229.19	**341**	
2009-10	568	-38	3	178	23	277	-147	-350	0	0		8	**522**	
2010-11	236	-23	17	(-)28	89	80	41	(-)102	0	0		3	**313**	
2011-12	325	-18	3	210	36	310	35	(-)134	0	0		-228	**539**	
2012-13	469	(-)22	(-)2	(-)58	72	209	18	(-)80	0	0		48	**654**	
2013-14	411	(-)23	(-)3	153	112	241	12	(-)30	0	0		(-)414	**459**	
2014-15	(-)452.04	16.31	(-)11.12	338.06	(-)55.35	607.76	63.07	(-)277.53	0	0		(-)363.28	**134.12**	
2015-16	597.73	-21.55	26.47	237.92	11.76	-75.08	152.76	73.96	0	0	1,003.97	-406.7	**597.27**	
2016-17	442.38	-21.28	-12.28	-29.48	29.09	-7.69	-77.3	32	0	0	355.44	-70.58	**284.86**	
2017-18	765.95	-21.39	-12.66	-42.9	61.54	-123.76	-101.05	32.45	0	0	558.18	-112.09	**446.09**	
2018-19	355.04	-17.74	-12.82	-13.54	616.63	88.19	-111.06	2.1	0	0	906.8	175.52	**1,082.32**	
2019-20	422.59	-15.21	-13.13	608.32	562.04	68.81	-145.19	0.47	-0.07	0	1,488.63	-60.41	**1,428.22**	

As discussed above, the recommendation of the Twelfth Finance Commission to prevent the Planning Commission from providing loans to the state government also contributed towards reduction of central loans (Government of Nagaland, for the years 2005-2010). This encouraged states to explore alternative financial strategies and improve their fiscal management. For Nagaland, this shift meant a greater emphasis on revenue generation and financial self-sufficiency. The state government has since focused on improving tax collection, managing expenditures efficiently, and seeking grants rather than loans for development projects. As a result of those changes, market borrowings have emerged as a significant source of financing the fiscal deficit of the state in recent times. During the first decade of the present century, market borrowing was found to be the major source of financing the gross fiscal deficit. Another significant source of borrowing for the government in recent years is the small savings and provident funds of the state government. It can be inferred from the above table that the existence of fiscal surplus has helped the states to repay the loans which in turn lead to decline in the debt-GSDP ratio of the state. This happened in the year 2003-04. But the huge fiscal deficit in the year 2019-20 has again raised the question of fiscal and debt sustainability of the state. As in any study of fiscal sustainability, primary deficit is always the key policy variable, it is necessary to study the trend and composition of primary deficit in the state which is carried out in the next sub-section.

4.6 Utilisation of borrowed funds

Borrowed funds should ideally be used to fund capital creation and developmental activities. Using borrowed funds for meeting current consumption and repayment of interest on outstanding loans is not sustainable. The trends of the total borrowing, repayment of earlier borrowings and utilisation during the five years from 2015-16 to 2019-20 are given in Table 4.6.

Table 4.6
Utilisation of borrowed funds ***(Rs. in crore)***

Year	2015-16	2016-17	2017-18	2018-19	2019-20
Total Borrowings	3,545.94	5,444.35	5,141.02	2,907.22	7,869.82
Repayment of earlier borrowings (Principal) ***(In per cent)***	2,705.35 (76.29)	5,056.03 (92.87)	4,452.01 (86.60)	2,596.27 (89.30)	6,867.25 (87.26)
Net capital expenditure ***(per cent)***	1,059.23 (29.87)	1,076.10 (19.77)	1,274.85 (24.80)	1,595.56 (54.88)	1,206.32 (15.33)
Net loans and advances	-0.31	-0.9	-0.9	4.19	8.18
Portion of Revenue expenditure met out of net available borrowings (2–3–4-5)	-218.33	-686.88	-584.94	-1,288.80	-211.93

Figures in parentheses represent percentage of these variables to Total Borrowings.
(-) implies excesses.
Source: Report of the Comptroller and Auditor General of India, Government of Nagaland, Various issues

As can be seen from Table 4.6, the borrowings were utilised for repayment of earlier borrowings which ranged between 76.29 per cent (2015-16) and 92.87 per cent (2016-17), during the five-year period of 2015-20. Total borrowings drastically reduced during the year 2018-19 but Net Capital Expenditure was 54.88 percent which was more than compared to other years.

4.7 Trend and Composition of Primary Deficit and Primary Revenue Deficit.

Primary deficit is that part of fiscal deficit which is net of interest payments. It represents the gap in resources for meeting the current obligations. The decomposition of primary deficit into primary revenue deficit and capital expenditure (including loans and advances) would indicate the quality of deficit and sustainability of the fiscal stance of a state. The primary revenue deficit which is calculated by deducting interest payments from revenue deficit measures the extent to which the additional debt build-up in the current year, independent of interest on inherited debt, is going towards current

expenditures rather than towards build up of assets through the capital account. Primary revenue deficit is considered as the first sustainability indicator as it constitutes the floor of the overall primary deficit. The timeseries data on trend and composition of primary deficit and primary revenue deficit of the state are shown in table 4.7.

Table 4.7
Trend and Composition of Primary Deficit and Primary Revenue Deficit of the State

(Rs. in Crore)

Year	Non-debt receipt	Primary Revenue Expenditure	Loans & Advances	Capital Outlay	Primary Expenditure	Primary Revenue Surplus/ Deficit	Primary Deficit
1	2	3	4	5	6 (3+4+5)	7	8 (6-2)
2000-01	1426.74	1290.23	6.45	224.4	1521.08	36.13	-94.34
2001-02	1532.33	1427.11	3.43	238.73	1669.27	102.58	-136.94
2002-03	1354	1292	2	341	1635	62	-281
2003-04	2367	1578	5	391	1974	789	393
2004-05	1846	1435	0	379	1814	411	32
2005-06	2273	1807	0	518	2325	466	52
2006-07	2776	1942	0	710	2652	836	124
2007-08	2998	2301	3	821	3125	697	-127
2008-09	3402.36	2574.45	1.46	853.09	3429	827.91	-26.64
2009-10	3722.68	2888.65	3.55	989.53	3881.73	834.03	-159.05
2010-11	5000.77	3791.98	4.12	1122.94	4919.04	1208.79	81.73
2011-12	5587.06	4456.51	2.75	1249.39	5708.65	1130.55	-121.59
2012-13	6203.18	5148.79	2.16	1255.18	6406.13	1054.39	-202.95
2013-14	6496.68	6204.8	0.92	1207.06	6462.25	1242.41	34.43
2014-15	7649.38	6760.14	0.19	1023.17	7228.16	1444.58	421.22
2015-16	8041.29	6992.69	0.19	1059.23	8052.11	1048.6	-10.82
2016-17	9440.88	8013.95	0.19	1076.10	9090.24	1426.93	350.64
2017-18	11017.54	9510.84	0.19	1274.85	10785.88	1506.7	231.66
2018-19	12210.23	10919.98	5.27	1595.56	12520.81	517.43	-310.58
2019-20	12238.12	11637.02	9.26	1206.32	12852.60	-213.73	-614.48

Source: Report of the Comptroller and Auditor General of India, Various issues

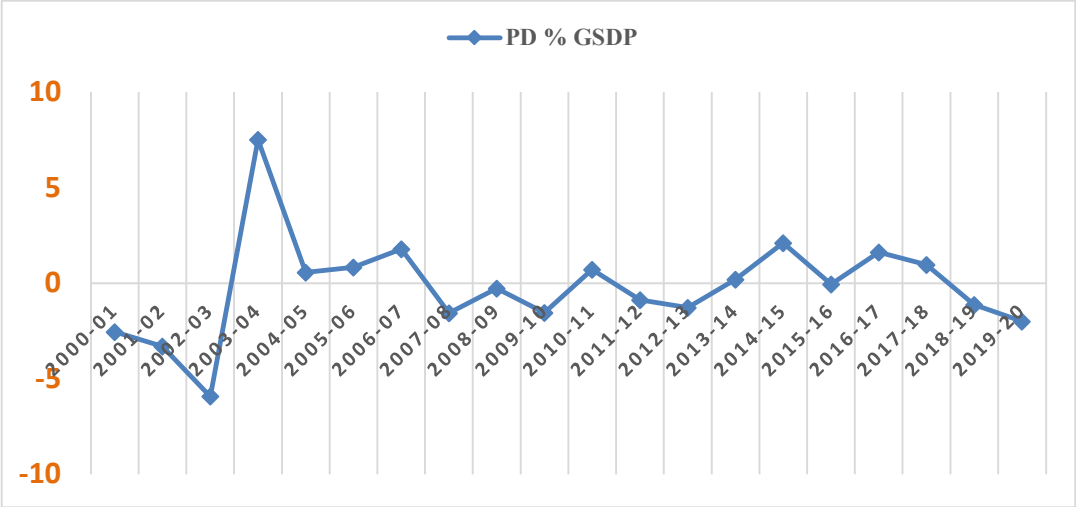
Note: Debt Receipts *include Market Loans, Bonds, Loans from financial institutions, Net transaction under Ways and Means Advances, Loans and Advances from Central Government, etc.*

Non-debt Receipts *include proceeds from disinvestment, recoveries of loans and advances.*

From table 4.7 above, it is found that the state experienced fluctuating primary deficit or surplus in 2000s. In the year 2002-03 the primary deficit of the state was at Rs. 281.00 crore constituting 5.92 percent of the GSDP. While in the year 2019-20 the primary deficit of the state was at all time high at Rs. 614.48 crore constituting 2.01 percent of the GSDP. The state also incurred a primary revenue deficit of Rs. 213.73 crore in the year 2019-20 implying that the debt taken during that year was going towards current expenditure. The moderate primary deficit of the state during the time periods 2008-09 and 2015-16 was due to the fact the non- debt receipt was higher or moderately lower than the primary expenditure of the state for the above-mentioned period. In the initial years of the first decade of the present century, the state was found to incur primary deficit in the year 2000-01 to 2002-03 and 2007-08 to 2009-10 which contributed towards fiscal instability of the state. Again, in the year 2019-20, the state has incurred huge primary deficit amounting to Rs. 614.48 crore implying the huge gap in resources for meeting the current obligations. The time series data on Primary deficit as a percentage of GSDP is also shown in figure 4.4.

Figure 4.4

Primary Deficit as a Percentage of GSDP of the State



It can be inferred from figure 4.4 that the state was able to earn primary surplus for consecutive years during the time period 2007-08 to 2009-10. But the state has again

incurred primary deficit in the years 2011-12 to 2012-13 amounting to 0.88 and 1.29 percent of GSDP respectively. Again, in the years 2018-19 to 2019-20 the primary deficit has again risen to 1.14 and 2.01 percent of the GSDP. This sudden rise in primary deficit raises concern about the state government's ability to sustain such huge primary deficit. Unless the growth rate of GSDP is sufficient to meet the interest on public debt, this will likely reduce the repayment capacity of the state. Under these circumstances, it is necessary to carry out a detailed analysis of debt sustainability of the state to find out whether the difference between growth rate of GSDP and interest rate on public debt is adequate to cancel out the effects of primary deficit.

4.8 DEBT MANAGEMENT

Public debt assuredly is one of the most powerful agents of economic transformation, provided it is utilized for the creation of productive capital assets that generate income; this income can be used for debt repayments without putting the economy into undue stress. Historically the special category states were disadvantages in many ways which made the cost of infrastructure creation as well as the cost of public service delivery within their territories much higher compared to other states. Besides, all these states are prone to severe natural calamities that often take them to the brink of disaster.

The state's debt problem has worsened after the substantial hikes of salary on the recommendation of successive Central Pay Commissions, when state governments are also forced to match the salary levels of their own employees with the central governments' pay scales, without having the resources to finance this huge additional burden. As a result, all states were forced to borrow more, throwing their finances completely out of gear. The problem hit the special category states especially hard. Without any resource of their own, this hike was clearly unsustainable, and they had to resort to large scale borrowings from the centre at high rates of interest (Bhattacharjee, 2016).

4.8.1 Sustainability of Public debt in Nagaland

Public debt is the accumulated stock of government financial liabilities. It is measured

by summing the face value of that stock (Rajaraman et al. 2005). In Indian context, public debt refers to all financial liabilities of the government, irrespective of whom they are owed (Lahiri and Kannon, 2004). A large accumulation of public debt may create problems for the state government in terms of repayment of the principal and interest payments. It also raises the issue of sustainability of the current stock of debt of the state. Sustainability is the capacity to endure without breaking down. In the context of public debt, sustainability embodies concern about the ability of the government to service its debt. A government which does not generate enough current revenues for debt service must either default on its obligations or borrow more to service its past debt as well as to cover ongoing imbalances. Continual borrowings of this kind are known as ponzi game which is reflected in the time path of debt-GSDP ratio. Usually, sustainability is measured in terms of debt-GSDP ratio. Generally, low debt-GSDP ratio is desirable as it indicates an economy that produces many goods and services and probably profits that are high enough to pay back debts. There is no universally prudent target value of debt-GSDP ratio (Chelliah, 2002; Buiter and Patel, 1992). Sustainability implies maintaining a stable debt-GSDP ratio over a period of time. Theoretical literature states that the existence of primary deficit or surplus has a close relation in maintaining a stable debt-GSDP ratio (Rath, 2005; Rajaraman, 2005). If a particular government fails to meet the repayment obligations of the public debt, it will lose its credibility in the debt market. This is very relevant as loans from the market are found to be a significant source of borrowings of the state government during the period of study. It is in this context that the issue of sustainability of the public debt in the state has gained its relevance in fiscal literature. The simplest way for determining the sustainability of debt of the states has been to arrive at the acceptable level of debt-GSDP ratio and the ratio of interest payments to total revenue receipts. It is very difficult to set a debt-GSDP ratio which is likely to be sustainable. The Twelfth Finance Commission of Government of India recommended 28 percent and 15 percent as acceptable level of the debt-GSDP ratio and the ratio of interest payments to total revenue receipts respectively. The time series data on outstanding liabilities, debt-GSDP

ratio and interest payments-revenue receipt ratio of the state government have been provided in table 4.8.

Table 4.8
Outstanding Liabilities, Debt to GSDP and Interest Payments to Revenue Receipts Ratio of the State

(Rs. in Crore)

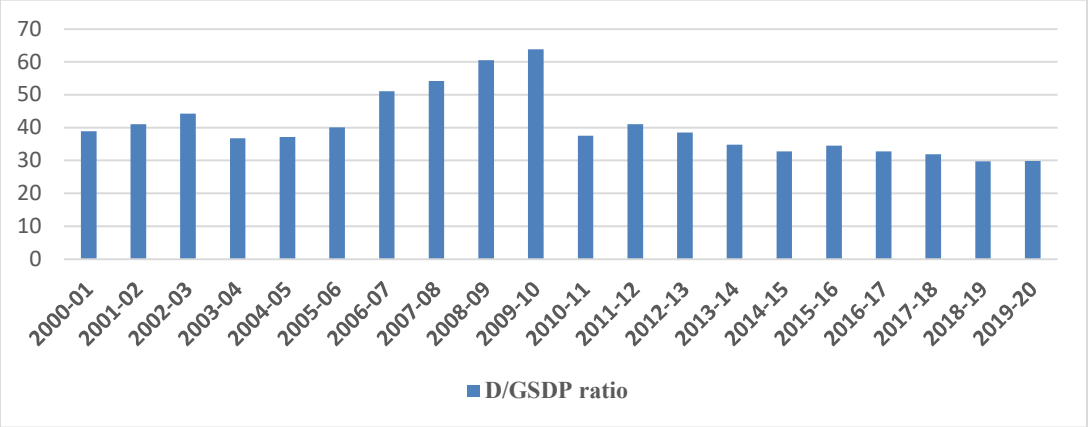
Year	Outstanding Liabilities	Debt-GSDP Ratio	Interest Payments – Revenue Receipts Ratio
2000-01	1429.93	38.86	14.12
2001-02	1695.93	41	15.14
2002-03	2102.22	44.27	15.93
2003-04	2542	36.73	9.95
2004-05	2813	37.14	13.57
2005-06	3189	40.04	11.2
2006-07	3554	51.08	10.09
2007-08	3881	54.14	9.03
2008-09	4571	60.52	9.23
2009-10	5402	63.75	9.75
2010-11	5773	37.48	7.89
2011-12	4860.44	41.05	7.47
2012-13	5247.37	38.53	7.27
2013-14	5786.85	34.84	7.6
2014-15	7953.73	32.76	7.26
2015-16	8931.64	34.5	7.29
2016-17	9557.35	32.76	6.73
2017-18	104,09.15	31.87	6.15
2018-19	10545.76	29.75	6.75
2019-20	12179.1	29.89	7.12

Source: Report of the Comptroller and Auditor General of India, Government of Nagaland, Various issues

It is evident from table 4.8 that the outstanding liabilities of the state government have increased from Rs.1429.93 crore in 2000-2001 to Rs. 12179.1 crore in 2019-20 and thus registering an annual compound growth rate of 11.30 percent during that period. The debt-GSDP ratio started increasing from 38.86 percent in the year 2000-01 to 60.52

percent in the year 2008-09. Since then, the debt-GSDP ratio of the state was found to decline from 63.57 percent in 2009-2010 to 29.89 percent in 2019-20. The state government faced the problem of fiscal instability during this period, i.e. 2006-07 to 2008-09. This is due to the fact that along with the high debt-GSDP ratio, the fiscal indicators of the state were found to deteriorate during that period. But, despite high debt-GSDP ratio, the state government was able to maintain a stable fiscal position during the time period 2014-15 to 2017-18 mainly due to the revenue and primary surplus attained by the state during that period. The fiscal instability of the state during the time period 2009-10 to 2013-14 prompted to adopt lots of fiscal reform measures which actually helped to maintain stable fiscal position. The debt-GSDP ratio of the state was found to decline from 34.5 percent in 2015-16 to 29.79 percent in 2018-19. These ratios are much lower than the level prescribed by the Twelfth Finance Commission.

Figure 4.5
Debt-GSDP Ratio of the State



It is evident from figure 4.5 that the state has experienced significant improvement in the debt- GSDP ratio during the period of study. Two main factors are found to contribute towards the decline in the debt-GSDP ratio of the state. As discussed in the previous sections, the declaration of the state as a special category state helped the state to receive more grants from the Planning Commission which were earlier provided as loans. The fiscal reform measures adopted by the state government after the fiscal crisis in the later part of 1990s also helped the state to reduce the debt-GSDP ratio of the

state. As state government has adopteddifferent fiscal reform measures during that time period, it is necessary to analyze the implication of those reform measures on the debt-GSDP ratio of the government.

4.9 Fiscal Reforms and Debt Status of the Government

The continuous fiscal imbalances from 1999-00 prompted the State Government to undertake different fiscal reforms measures targeting specifically the deficit indicators. The Eleventh Finance Commission of Government of India (2000-2005) fixed cumulative improvement in the reduction of revenue deficit as proportion of revenue receipts at 16 percentages for special category states like Nagaland during the award period of Eleventh Finance Commission. As against the target of 16 percent, Government of Nagaland achieved 30.44 and 32.20 percent cumulative improvement in reduction of revenue deficit as a percentage of revenue receipts during the years 2001-02 and 2002-03 respectively. In the subsequent years the state experienced Fiscal and Revenue surplus in 2003-04 and Revenue surplus in 2004-05.

As a result, the Government of Nagaland was able to receive Rs. 5536.50 crore as non-plan revenue deficit grant from the incentive fund under Fiscal Reform facility of the Twelfth Finance Commission (2005-10). Further, in pursuance of the award of the Twelfth Finance Commission, the Government of Nagaland enacted Nagaland Fiscal Responsibility and Budget Management Act (NFRBM), 2005 to qualify for debt relief. As discussed in the previous chapter, the main objective of the NFRBM Act was to reduce the revenue deficit to zero and fiscal deficit to 3 percent of GSDP gradually by 2008-09 from the initial award period of Twelfth Finance Commission. With the implementation of the NFRBM Act and adoption of the Medium-Term Fiscal Reform Plan Government of Nagaland achieved the fiscal targets of NFRBM Act in the initial years of the Twelfth Finance Commission award period. The revenue deficit, which was Rs.1.59 crore in the year 2002-03 turned into a surplus of Rs. 5.46 crore in 2003-04. Similarly, the fiscal deficit, which was Rs. 494.97 crore in 2002-03 turned into deficit of Rs. 218 crore in 2004-05, Rs. 306 crore in 2005-06, and Rs.156 crore in 2006-07.

As an incentive under the Debt Consolidation and Reform Facility (DCRF) of the Twelfth Finance Commission recommended debt waiver of Rs. 21.35 crore and interest waiver of Rs. 56.06 crore for the years 2005-2010. The actual waiver for the years 2005-2010 is shown at table 4.9.

Table 4.9

Debt/Interest Relief availed by Nagaland under DCRF recommended by Twelfth FC

(Rs. in crore)

Year	Debt Relief	Interest Relief
2005-06	0	13
2006-07	16	12
2007-08	13	10
2008-09	16	10
2009-10	0	9
Total	**45**	**54**

Source: Reserve Bank of India, State Finances, A Study of Budgets (Various Reports)

The actual waiver for the years 2005-2010 shows an increase of debt relief to Rs. 45 crore and decrease of interest relief to Rs. 54 crore. Thus, adoption of fiscal reform measures has helped the state to restrict the deficit indicators and gain from different incentive schemes of the central government.

The fiscal consolidation roadmap recommended by the XIV FC had set the following targets relating to debt sustainability – Debt should be less than 38.73 per cent of GSDP; and Interest payments should be less than 10 per cent of Revenue Receipts. The outstanding debt to GSDP for Nagaland stood at Rs. 57.7 core to Rs 52.3 crore in 2009-10 to 2014-15 respectively which is much higher than the target of 38.73 per cent. Moreover, interest payments were always more than 10 per cent of Revenue Receipts prescribed by the XIV FC.

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CHAPTER 5

SUMMARY AND CONCLUSION

5.1 Implications of the Study

The role of fiscal policy in economic growth has an important place in economic research and economic theory since it provides a framework for understanding and influencing macro-economic outcomes. The modern fiscal policy defines the basic directions of the use of financial resources of the state, means of financing, and main sources of updating the treasury. Depending on concrete historical conditions in different countries such policy (politics) has its own features. At the same time developed countries use a set of common measures. It includes straight and indirect financial methods of regulation of the economy.

The need to start the fiscal reform process as a part of economic reforms in 1990-91 was realised. The Indian fiscal reform programme is based on the policy of gradualism and evolutionary transition rather than rapid restructuring 'shock therapy' (Mathur, 2001) but now a period of three decades is over, so it seems important to analyse and assess the usefulness of the reforms. Fiscal reforms are necessary, though not a sufficient condition for enabling the state governments to be more effective agents of development. Improving the efficiency, effectiveness and transparency of government's operations is equally important.

The FRBM Act is a fiscal sector legislation enacted by the Government of India in 2003, aiming to ensure fiscal discipline for the centre by setting targets including reduction of fiscal deficits and elimination of revenue deficit. Though the Act aims to achieve deficit reductions prima facie, an important objective is to achieve inter-generational equity in fiscal management. Other objectives include long run macroeconomic stability, better coordination between fiscal and monetary policy, and transparency in fiscal operation of the Government. The Nagaland Fiscal Responsibility and Budget

Management (FRBM), Act 2005, enacted under the 12th FC recommendations. Since 2006, the Act has been amended 4 times in 2009, 2011, 2021 and 2022.

Therefore, a modest attempt was made in this thesis with the following objectives in mind: to assess the impact of fiscal reforms on fiscal performance of the state government and to compare revenue, expenditure and fiscal and debt sustainability of the state Nagaland in the post-reform period. The fiscal performance of the state government of Nagaland for the period of 2000-01 to 2019-20 has been analysed.

5.2 FINDINGS

5.2.1 Findings related to the impact of reforms on public expenditure.

The state governments have the responsibility of both maintaining law and order and providing most of the economic and social infrastructure. They are closer to the people and have direct interface with them which makes them prone to comments on governance, quality of expenditure, applications of resources and performance of the services provided (Lahiri, 2000; Shariff et al. 2002). As a result, proper allocation and prioritisation of the expenditure of the state governments have been an issue of discussion in recent times. This is more significant in a state like Nagaland where public investment plays a significant role in economic development. Due to its difficult geographical terrain and poor infrastructure, private sectors are not willing to invest in the state. State government, through its investment on social and physical infrastructure, has to remove those bottlenecks that hinder the development of the state. At the same time, state government has to judiciously use its limited resources to maintain fiscal stability. The growth of public expenditure on priority sectors is expected to lead the state into the path of economic development. Under these circumstances, it is necessary to analyse the trend and pattern of public expenditure of the state during the period under consideration.

The total (aggregate) expenditure of the state government has increased from Rs.

1531.98 crore in 2000-01 to Rs. 4244.24 crore in the year 2009-10 and registering a compound annual growth rate of 10.73 percent during that period. Similarly, the aggregate expenditure of the government has increased from Rs. 5313.37 crores in 2010-11 to Rs. 12852.60 crores in 2019-20 and thus registering a growth rate of 9.24 percent during that period. The average ratio of total expenditure to GSDP of the state during the period of study is found to be 41.97 percent.

Revenue expenditure constitutes the major portion of the total expenditure of the state during the period of study ranging from 75.74 percent in the year 2007-08 to 90.54 percent in the year 2019-20 while capital outlay is found to constitute, on an average, 17.24 percent of the total expenditure of the state and expenditure on loans and advances is found to constitute a meager 0.11 percent of the total expenditure of the state .

Interest payments and servicing of debt, administrative services and pension constitute more than 95 percent of the revenue expenditure on general services with a compound growth rate of 8.34, 10 and 16.24 percent respectively during 2000-01 to2019-20. Expenditure on education, sports, art and culture has constituted 57.13 percent of the revenue expenditure on social and community services. While agriculture and allied activities have constituted 26.32 percent of the revenue expenditure on economic services.

Capital outlay constituted, on average, 98.84 percent of the total capital expenditure implying that there had been huge burden of repayment of public debt. Expenditure on economic services constitutes on average 41.24 percent of the total capital expenditure with a compound growth rate of 8.47 percent. Transport and Communication expenses constitute the major portion of the capital outlay which contributed, on an average, 41.24 percent of the total capital expenditure on economic services during the study period.

Increase in capital outlay on economic services has been noticed during the time period from 2010-11 to 2019-20 compared to the previous decade which points to the fact that

the government has given more emphasis on economic services for development of the economy of the state.

The committed expenditure constituted 60 per cent or more of Revenue Expenditure during the study period from 2000-01 to 2019-20. The percentage of salaries, pensions and interest payments within Revenue Expenditure was highest in 2000-01 (73.10 percent) while the percentage of non-committed expenditure to RE was the highest in 2017-18 during the period. It signifies limited flexibility of the State to allocate and spend on areas of non-committed expenditure.

Developmental revenue expenditure of the state government has increased from Rs. 737.32 crore in 2000-01 to Rs. 6208.22 crore in 2019-20 and thus registering a compound growth rate of 11.24 percent. The compound growth rate of developmental capital expenditure of the state during the study period is found to be 6.23 percent as it has increased from Rs. 310.92 crore in 2000-01 to Rs. 1040.59 crore in 2019-20.

The development expenditure has increased from Rs.1048.24 crore in 2000-01 to Rs.7248.81 crore in 2019-20. It has grown at an annual trend growth rate of 11.50 per cent and compound annual growth rate of 10.15 per cent. Ratio to GSDP has moved around 28.49 per cent up to 2000-01 with maximum 29.82 percent in 2016-17.

The per-capita developmental expenditure has increased from Rs. 5,241.2 crore in 2000-01 to Rs. 36,244.05 in 2019-20 and thus registered a compound growth rate of 10.15 percent during that period. Similarly, per-capita expenditure on economic and social services has increased from Rs. 98.57 crore and Rs. 130.67 crore in 2000-01 to Rs. 608.52 crore and Rs. 742.47 crore in 2019-20 respectively. The compound growth rate of these two components of expenditure is found to be 9.53 and 9.07 percent respectively during the above-mentioned period. During 2000s, per-capita developmental expenditure has increased from Rs. 5241.2 crore in 2000-01 to Rs. 12,322 in 2009-10 and thus registering positive compound growth rate of 8.92 percent. After that, improvement was observed in per-capita development expenditure during the second decade of the present century with a compound growth rate of 8.35 percent. This was mainly due to the improvement in the fiscal position of the state in recent years. The

improvement in the fiscal position of the state gives flexibility in investing more in developmental activities.

The per-capita expenditure on social services, economic services and per-capita development expenditure of the state have shown improvement during the time period 2000-01 to 2019-20. Per-capita expenditure on social services has been found to be lower than the per-capita expenditure on economic services during the period of study. It is evident from the above discussion that the state has experienced an increase in per-capita development expenditure in recent years.

5.2.2 Findings related to the impact of reforms on Fiscal and Debt Sustainability of the State.

Nagaland's GFD/GSDP was at 4.8 per cent during 2010-11 which shows a huge improvement from 8.5 percent during the year 2000-01. However, during 2016-17 the GFD/GSDP came down to 2.10 percent which is much below the FRBM threshold of 3 percent.

During the first half of the 2000s, the state experienced revenue deficit in the year 2000-01 to 2002-03 then the state experienced a huge revenue surplus amounting to Rs. 546.8 crore in the year 2003-04. In the year 2014-15 the Revenue Surplus had a record high of Rs. 888.53 crore but reduced in the next year and continued with increasing trend. But in the year 2019-20, the state experienced an increase in revenue expenditure of 14.98 percent compared to the increase in revenue receipt of - 0.12 percent. In fact, the state incurred a huge revenue deficit of Rs. 1420.1 crore (- 4.65 percent of GSDP).

The growth rate of revenue expenditure throughout the study period was found to increase in subsequent years. But the amount of revenue expenditure remained greater than revenue receipt during the years 2000-01 to 2002-03 and 2019-20. The principal factors responsible for the burgeoning revenue expenditure in that period were the relentless increase in expenditure on salaries, wages and pension, known as committed

expenditure and growing debt servicing obligations on account of a significant increase in borrowings mostly to meet revenue expenditure requirements. The increase in revenue expenditure on salaries and wages was mainly due to implementation of the new payscale in line with the recommendations of the Fifth and Sixth Central Pay Commissions which imposed an additional fiscal burden on the state government. Moreover, high level of financial support to Public Sector Undertakings necessitated by their inability to meet their obligations led to increase in revenue expenditure during that period.

But during 2003-04 to 2018-19, the state was able earn revenue surplus for consecutive years. It was found that fall in the relative growth of revenue expenditure compared to revenue receipts contributed towards improvement in the revenue position of the state.

The composition of fiscal deficit reveals that during first half of the 2000s, the state experienced revenue surplus in one year only in 2003-04 to meet some portion of the capital outlay and for extending loans for developmental purposes. This was mainly due to the revenue surplus of Rs. 546.8 Crore. The revenue surplus was impacted by a one-time grant-in-aid of Rs. 365 crore, which was included in the state's revenue and hence earned a fiscal surplus of Rs. 157.4 crore. This grant-in-aid significantly influenced the state's finances for that period.

During the period, 2010-11 to 2013-14 major Capital Outlays were made by the Government for infrastructure projects.

The state is found to violate the target of Nagaland Fiscal Responsibility and Budget Management Act on Fiscal Deficit in year 2007-08 for the first time after the introduction of the Act in 2005.

Market borrowings were the main sources of financing gross fiscal deficit of the state during the study period. The borrowings were utilised for repayment of earlier borrowings which ranged between 76.29 per cent (2015-16) and 92.87 per cent (2016-17), during the five-year period of 2015-20.

Outstanding liabilities of the state government have increased from Rs.1429.93 crore in 2000-2001 to Rs. 12179.1 crore in 2019-20 and thus registering an annual compound

growth rate of 11.30 percent during that period. The debt-GSDP ratio started increasing from 38.86 percent in the year 2000-01 to 60.52 percent in the year 2008-09. Since then, the debt-GSDP ratio of the state was found to decline from 63.57 percent in 2009-2010 to 29.89 percent in 2019-20.

Despite high debt-GSDP ratio, the state government was able to maintain a stable fiscal position during the time period 2014-15 to 2017-18 mainly due to the revenue and primary surplus attained by the state during that period. The fiscal instability of the state during the time period 2009-10 to 2013-14 prompted to adopt lots of fiscal reform measures which actually helped to maintain stable fiscal position. The debt-GSDP ratio of the state was found to decline from 34.5 percent in 2015-16 to 29.79 percent in 2018-19. These ratios are much lower than the level prescribed by the Twelfth Finance Commission.

With the implementation of the NFRBM Act and adoption of the Medium Term Fiscal Reform Plan Government of Nagaland achieved the fiscal targets of NFRBM Act in the initial years of the Twelfth Finance Commission award period. The revenue deficit, which was Rs.1.59 crore in the year 2002-03 turned into a surplus of Rs. 5.46 crore in 2003-04.

As an incentive under the Debt Consolidation and Reform Facility (DCRF) of the Twelfth Finance Commission recommended debt waiver of Rs. 21.35 crore and interest waiver of Rs. 56.06 crore for the years 2005-2010. The actual waiver for the years 2005-2010 shows an increase of debt relief to Rs. 45 crore and decrease of interest relief to Rs. 54 crore. Thus, adoption of fiscal reform measures has helped the state to restrict the deficit indicators and gain from different incentive schemes of the central government.

5.2.3 Findings related to the fiscal scenario of Nagaland during the post- reform period on the revenue generation efforts of the government

The revenue receipts of the state increased considerably in 2003-04 as compared to the previous year (75.20 percent) from Rs. 1346.90 to Rs. 2359.79 crore. Revenue Receipts

increased by Rs. 1398.71 crore (17.38 per cent) from Rs. 8043.57 crore in 2015-16 to Rs. 9442.28 crore in 2016-17 due to increase in grants from State's share of Union Taxes and Duties (Rs. 491.49 crore). Revenue Receipts (RR) as the percentage of Aggregate Receipts (AR) was highest in 2003-04 at 78.09 percent and lowest just before that year in 2002-03 at 47.79 percent.

The total revenue of the state government has increased from Rs.1254.10 crore in 2000-01 to Rs. 11,423.29 crore in 2019-20. The compound growth rate of total revenue is found to be 12 percent for the above time period.

The own tax revenue of the state government has increased from Rs. 46.25 crore in 2000-01 to Rs. 958.23 crore in 2019-20. The compound annual growth rate of own tax revenue during the study period is found to attain the highest value of 16 percent among all categories of revenue. For the same time period, non-tax revenue of the state has increased from Rs.39.23 crore in 2000-01 to Rs. 339.29 crore in 2019-20 with a compound growth rate of 11 percent. Similarly, shared taxes and grants-in-aid have increased from Rs.96.48 and Rs. 1972.14 crore in 2000-01 to Rs. 3,267.08 and Rs. 6,858.69 crore respectively in 2019-20. The compound growth rate of these two sources of revenue is found to be 19 percent and 10 percent respectively during the above-mentioned period.

The compound annual growth rate (CAGR) of total revenue is found to be higher in the first decade of the present century than in the present decade. The CAGR during the time period 2010-11 to 2019-20 was 9 percent only as compared 15 percent for the time period 2000-2001 to 2009-10. The compound growth rate of tax and non-tax revenue of the state is found to be 15 percent and 6 percent during the time period 2010-11 to 2019-20 compared to 17 and 17 percent respectively in the previous decade. Similarly, the growth rate of central transfers in terms of shared taxes and grants-in-aid has experienced a growth rate of 17 and 6 percent during the time period 2010-11 to 2019-20 compared to 22 and 14 percent respectively during 2000-01 to 2009-10.

It is also necessary to examine the percentage contribution of different revenue sources towards state government's exchequer to examine the significance of each source of revenue.

Central transfers constitute a major portion of the state's total revenue during the study period. It has been noticed that the central transfers, on average, constitute more than 90 percent (average of total years) of the total revenue receipt during the period of study. The dependence of the state on central transfers remains more or less same during the study period. In the year 2019-20, central transfers contributed 89 percent of the total revenue compared to 93 percent in the year 2000-01. Over-dependence of the state on central transfers reflects the inability of the state to undertake developmental activities with its own resources.

Among the own revenue, tax revenue is found to be major contributor for the period taken for analysis.

Own resources-revenue receipt ratio of the state is found to be low compared to all states for all the sub-periods considered for the analysis. The comparative performance of the state to that of major states and special category states' average has been found to be much lower for each of the sub-periods. But improvements in the ratio of the state have been noticed during the time period 2005-2010 compared to 2000-05 as well as during 2015-20 compared to 2010-15. On the other hand, improvement in the ratio of the state has been noticed in the time period 2010-15 compared to the time period 2005-10.

The amount and percentage of shared taxes and grant-in-aid as provided by the Finance Commissions to the state was analysed and it was found that compared to grants-in-aid, tax sharing constitutes a lesser proportion of Finance Commission transfers to Nagaland. It constituted 18.61 percent of the total Finance Commission transfer under the period of Eleventh Finance Commission (FC-XI). On an average, it constituted 35.88 percent of the total Finance Commission transfers during the period under consideration. The

reduced share of Non Plan Revenue Deficit (NPRD) grant received by the state is found to be the main factor for declining share of grants-in-aid compared to shared tax. As recommended by FC-IX, NPRD grants recommended by the FC-XII were 39.86 per cent of the total grants. FC-XIII recommendations for NPRD grants amount to 16.26 per cent of the total grants, the lowest ever in FC recommendations. It has been found that during the period of the Thirteenth Finance Commission, the state received NPRD grants of only Rs. 8146 crores for the year 2010-11 to 2014-15.

Grants from the Planning Commission constitute a significant proportion of the grants-in-aid to the state during the period under study. Nagaland was declared as a special category state in 1969 which resulted in drastic change in the grant to loan composition of plan assistance from previous 30: 70 to 90: 10. As a result, share of grants for the state plans jumped from 384.55 crore (35.85 percent) of total grants in the year 2000-01 to 2283.84 (46.17 percent) in the 2013-14.

The other three components of transfers (Grants for Central Sector, Centrally Sponsored and Special Plan Schemes) on average, have constituted 17.62 percent of the total grants-in-aid during the study period. Among these three components, share of centrally sponsored scheme is found to be dominant as it constitutes, on average, 14.59 percent of the total transfers. As a North-east state, Nagaland gets additional share of the grants provided for implementation of the infrastructure projects of the region under the aegis of North Eastern Council. It constituted on an average, 1.66 percent of the total grants in the year. The percentage of grants from NEC ranged from 2.63 to 0.55 percent of the total grants in the years 2012-13 and 2019-20 respectively.

The amount and percentage contribution of different sources of tax revenue towards total own tax revenue of the state has been analysed and it was found that sales tax/VAT contributed the major portion of the state's own tax revenue during the period under consideration. On the other hand, taxes such as land revenue and Taxes & Duties on

Electricity have lost their significance, and their contribution has declined during the time period 2000-01 to 2019-20.

The average growth rate of sales tax during the period 2000-01 to 2004-05 (pre-VAT) was found to be 15.82 per cent while the growth rate for the period 2005-06 to 2009-10 was 13.32 percent. Thus, the average growth rate in the post VAT period registered a decrease of 2.5 per cent implying that implementation of VAT in the state is not as productive as expected by the government. The decline in the growth rate during the post-VAT period may suggest that VAT is not beneficial for importing states where value addition is lower relative to the exporting states. As Nagaland is a net importing state, this may imply that not much value addition has taken place in the state. Also, no improvement has been observed in the volatility of revenue collection in the post-VAT period. The state even experienced negative growth of sales tax revenue in the year 2013-14.

The Nagaland Goods and Services Tax (GST) Act, 2017 was passed by the State Legislature in May 2017 and made effective from 01 July 2017 in the State. The first year of GST implementation resulted in a high growth rate of 103.38 percent (Combined VAT & GST collection) during 2017-18. However, the same fell to a negative growth rate of -10.17 percent in the next year 2018-19. Over time, Sales Tax/VAT was fully subsumed into GST, leading to gradual improvements in tax revenue collection.

In case own non-tax revenue, proceeds from receipts from economic services are the major contributor of the for the study period. On an average, has contributed 63.10 percent of the total non-tax revenue of the state for the period taken for analysis. Proceeds from interest receipts have gained significance during the period of study.
The contribution of other sources of non-tax revenue especially General services and Social services has been significant during the study period. The compound growth rate of General services and Social services during the study period were 12 and 15.19

percent respectively. On an average General service and Social services contribute 16.26 and 16.05 percent of State's Own Non-Tax Revenue during 2000-01 to 2019-20.

5.2.4 Findings related to the evaluation and comparison of the trends and patterns in the revenue and expenditure indicators after the implementation of Nagaland Fiscal Responsibility and Budget Management Act, 2005.

Though the Act aims to achieve deficit reductions prima facie, an important objective is to achieve inter-generational equity in fiscal management. This is because when there are high borrowings today, it should be repaid by the future generation. But the benefit from high expenditure and debt today goes to the present generation. Achieving FRBM targets thus ensures inter-generation equity by reducing the debt burden of the future generation. Other objectives include: long run macroeconomic stability, better coordination between fiscal and monetary policy, and transparency in fiscal operation of the Government.

The Nagaland Fiscal Responsibility and Budget Management (FRBM), Act 2005, enacted under the 12th FC recommendations. **Revenue Deficit:** The 2005 Act required the State to remain revenue surplus by making a balance in revenue receipts and expenditure and build up further surplus. **Fiscal Deficit:** The initial Act mandated the State to reduce its fiscal deficit-to-GSDP ratio to 3 percent of projected GSDP by the year ending 31st March 2009. The 2009 amendment raised the fiscal deficit to 3.5 percent of the estimated GSDP by 31st March 2010. The 2011 amendment required the State to achieve fiscal deficit of 3 percent of projected Gross State Domestic Product (GSDP) by the year ending 31st March 2015. The 2020-21 amendment fixed fiscal deficit levels to be – 5 percent in 2020-21, 4 percent in 2021-22, 3.5 percent in 2022-23, and 3 percent 2023-24 onwards. **Debt:** Initially the State Act of 2005 mandated the State to ensure that the total debt stock do not exceed 40 percent of the estimated GSDP for that year within a period of 5 years, beginning from the initial financial year on the 1st April 2005, and

ending on the 31st March 2010. The 2011 amendment required the State to achieve debt to GSDP ratio of 56.8 percent in 2010-11 and reduce it to 52.3 percent by 2014-15. The 2021 amendment limited the amount of annual incremental risk weighted guarantees to 1 percent of the estimated GSDP of the year preceding the current year. Further the total guarantees at any point of time shall not exceed 5 percent of the estimated GSDP of the year preceding the current year. **Fiscal Discipline:** As per the State Finances Audit Report of the Comptroller and Auditor General of India (CAG), during the period from 2017-18 to 2021-22, the State missed achieving the revenue deficit targets only once in five years (2019-20), but fiscal deficit targets thrice (from 2018-19 to 2020-21). And the State also failed to achieve the targeted ratios for the outstanding liabilities for three out of five years (2017-18, 2019-20 and 2020-21) (NITI Aayog, 2025).

Implications of Nagaland FRBMA: Nagaland had enacted the FRBMA in 2005-06 and was able to generate revenue surpluses since then. With FRBMA, its finances have been looking up. The Fiscal Deficit to GSDP ratio declined from double digits till 1991 to 2.7 percent, i.e., within the FRBMA limits in 2010-11. Debt-GSDP ratio has also been going down. In 1974-75 the ratio had increased to an unsustainable 77 percent, but had gradually come down to 41.6 percent in 2010-11, which was still at a dangerous level. But the State appears to have emerged from the most vicious debt trap into which it was falling almost irrevocably.

Nagaland FRBM Act of 2005 contributed to incremental progress in fiscal discipline and administrative transparency; it did not achieve transformational improvements in revenue mobilization or fundamental changes in fiscal structure. Given these observations, the first hypothesis that "there is no significant impact of fiscal reforms in Nagaland after the implementation of the FRBM Act, 2005" is largely substantiated when measured by transformational shifts in revenue mobilization or fiscal structure. The state's experience reflects broader patterns among special category states, where reforms yielded modest improvements constrained by structural economic and administrative limitations. True fiscal transformation requires deeper structural reforms,

economic diversification, and continued institutional capacity building beyond legislative frameworks alone.

Fiscal consolidation measures

Fiscal consolidation refers to policy actions aimed at reducing government deficits and debt accumulation - primarily through expenditure restraint, improved tax administration, phased-out subsidies, rationalized public spending, and enforcing deficit targets as mandated by acts like FRBM.

The hypothesis that "Fiscal consolidation measures adopted by the State government to correct fiscal imbalances have ensured fiscal stability in the state" is partially substantiated. Fiscal consolidation measures, including those mandated by the FRBM Act, did enable Nagaland to correct fiscal imbalances and achieve a degree of fiscal stability—particularly with regard to deficit and debt management. However, true fiscal stability is multidimensional and goes beyond meeting quantitative targets. The sustainability of this stability remains uncertain as it relies heavily on continued central transfers and does not yet reflect deep structural reforms or robust own-source revenue growth.

In the next section Multiple Regression Analyses examines the connection between GSDP and fiscal aggregates (total revenue, total expenditure, and total debt) affect GSDP and also the GSDP and fiscal health metrics (Revenue Deficit, Primary Deficit, and Fiscal Deficit).

5.3 Multiple Regression Analysis

Table 5.1

1. Model 1: Multiple Regression of GSDP on Total Revenue, Total Expenditure, and Total Debt

GSDP	Coefficient	Standard Error	t	P>|t|	
Revenue Deficit	1.235333	2.682417	0.46	0.651	
Primary Deficit	33.32887	8.019295	4.16	0.001	
Fiscal Deficit	-36.2272	4.997156	-7.25	0.000	
Constant	-1677.503	2410.21	-0.70	0.496	
R^2	0.7743	Source	ss	df	ms
Adjusted R^2	0.7320	Model	1.0156e+09	3	338534739
Number of Observation	20	Residual	295993523	16	18499595.2
		Total	1.3116e+09	19	69031460

2. Model 2: Multiple Regression Analysis of GSDP on Fiscal Deficit, Revenue Deficit and Primary Deficit

GSDP	Coefficient	Standard Error	t	P>|t|	
Total Revenue	-0.4249315	.8811403	-0.48	0.636	
Total Expenditure	2.354058	.8238085	2.86	0.011	
Total Debt	0.2990437	.3235084	0.92	0.369	
Constant	458.7624	480.8207	0.95	0.354	
R^2	0.9892	Source	ss	df	ms
Adjusted R^2	0.9871	Model	1.2974e+09	3	432463682
Number of Observation	20	Residual	14206693.3	16	887918.334
		Total	1.3116e+09	19	69031460

*Calculated using **STATA 17***

Two multiple regression models that look at the factors influencing GDP are presented in the analyses as above. Ordinary least squares (OLS) estimation was used in both models in which each have three predictor variables and a sample of 20 observations.

With an R^2 of 0.9892 and an adjusted R^2 of 0.9871, Model 1, examines how fiscal aggregates (total revenue, total expenditure, and total debt) affect GSDP, which shows excellent explanatory power. While Model 2 with an R^2 of 0.7743 and an adjusted R^2 of 0.7320, examines the connection between GSDP and fiscal health metrics (Revenue Deficit, Primary Deficit, and Fiscal Deficit).

Model 1: Coefficient Analysis of Fiscal Aggregates and GSDP

The first model sheds light on how fiscal policy tools directly affect economic production. The only statistically significant predictor that shows a positive relationship between government spending and GSDP is the total expenditure ($\beta = 2.35$, $t = 2.86$, $p = 0.011$). This result is consistent with the Keynesian multiplier effect, which holds that government spending increases economic activity and aggregate demand.

Although this link is not statistically proven, total revenue shows a negative but statistically insignificant coefficient ($\beta = -0.42$, $t = -0.48$, $p = 0.636$), indicating that revenue collection - likely through own revenue like taxes - may have a moderate contractionary effects on economic activity.

When other fiscal variables are taken into account, the link between total debt and GSDP is positive but not statistically significant ($\beta = 0.30$, $t = 0.92$, $p = 0.369$).

Model Diagnostics

With an F-statistic of 487.05., this model explains 98.9% of the variance in GSDP, indicating remarkable explanatory power. Even after accounting for degrees of freedom, the model's high adjusted R^2 of 0.9871 shows that it still has a remarkable predictive capacity.

Model 2: Coefficient Analysis of GSDP and Deficit Variables

The impact of various deficit measures on GSDP exhibits notable variation, according to the second model. A statistically significant positive predictor ($\beta = 33.33$, $t = 4.16$, $p = 0.001$) is Primary Deficit, indicating that greater primary deficits are linked to higher

GSDP. This surprising result might be the result of expansionary fiscal policy, which boosts economic growth in the short run even when government expenditure is financed by borrowing.

A significant negative correlation between fiscal deficit and GSDP is shown ($\beta = -36.23$, $t = -7.25$, $p < 0.001$), suggesting that overall fiscal imbalances will limit economic activity. The size and importance of this variable imply that any stimulative advantages are outweighed by the crowding-out effects and sustainability issues connected to significant fiscal deficits for the state.

When all other deficit measures are taken into account, the revenue deficit component by itself does not significantly affect economic output, as seen by the lack of a statistically significant link between it and GSDP ($\beta = 1.24$, $t = 0.46$, $p = 0.651$).

Model Diagnostics

Overall statistical significance is indicated by the model's F-statistic of 18.30, which explains 77.4% of the variance in GSDP. After taking into consideration the number of predictors in relation to the sample size, the adjusted R^2 of 0.7320 indicates strong explanatory power.

Comparative Evaluation and Consequences

Model	**R^2**	**Adjusted R^2**	**F-statistic**	**Significant Variables**
Model 1 (Aggregates)	0.9892	0.9871	487.05	Total Expenditure (+)
Model 2 (Deficits)	0.7743	0.7320	18.30	Primary Deficit (+), Fiscal Deficit (-)

Model 1 is more predictive than Model 2, accounting for 98.9% of the variation in GSDP as opposed to Model 2's 77.4%. This implies that, as opposed to stock-based deficit measurements, fiscal flow variables - such as revenue and expenditure - have a stronger correlation with economic output.

Interpretation and Conclusion

The findings offer conflicting evidence in favor of fiscal policy theories. Arguments for expansionary fiscal policy are supported by the significant positive impact of total expenditure in Model 1 and the positive coefficient for primary deficit in Model 2. However, the negative Fiscal Deficit coefficient suggests that fiscal sustainability concerns and crowding-out effects become dominant when deficits reach certain thresholds.

According to the analyses, the main fiscal driver of GSDP growth is government expenditure, whereas the link between fiscal deficits and GDP growth is complicated and heavily influenced by their composition and size. These findings have significant ramifications for the formulation of fiscal policy, indicating that sustaining favorable economic outcomes depends on the durability and structure of government finances.

The findings suggest that policymakers should focus on both the level and composition of government expenditure rather than solely managing deficit ratios. The positive relationship between expenditure and GSDP in Model 1, combined with Model 2's mixed deficit effects, indicates that strategic spending may be more beneficial than austerity measures for economic growth.

The results provide robust empirical evidence for fiscal policy's complex relationship with regional economic performance. The contrasting model performances highlight the importance of variable selection in economic modeling and suggest that traditional deficit-focused analyses may miss crucial dynamics captured by flow-based approaches. The statistical rigor demonstrated through comprehensive model diagnostics, including R^2 values, F-statistics, and individual coefficient significance tests, provides a solid foundation for further academic discourse on fiscal federalism and regional development policy.

5.4 RECOMMENDATIONS

The following recommendations are put out in light of the research findings in order to strengthen fiscal reform initiatives that will significantly improve state finances.

5.4.1 Revenue

Policy and fiscal management

Enhancing tax collection: Make it simpler to collect existing taxes, such as motor vehicle taxes, property taxes, and registration fees. This could entail modernizing processes and utilizing technology to prevent tax evasion.

Investigate new revenue streams: The state ought to consider implementing congestion fees or environmental taxes that are tailored to its own requirements.

Discovering New Taxes: Investigate novel revenue streams, such as pollution taxes or traffic fees tailored to the particular circumstances of each state. To maximize revenue, consider streamlining existing tax cuts and subsidies as well.

Justify Tax Exemptions and Subsidies: To maximize revenue without harming vital sectors of the economy, the state should examine the tax benefits it already offers.

Enhance Fiscal Federalism: States ought to collaborate with the GST Council and request a larger share of funding through Finance Commissions.

Diversification and economic growth

It is imperative that the state government develop its budgetary reform programmes, which must involve, among other things, reorganizing some of its losing departments, such the Department of Power (DoP), Nagaland State Transport (NST), etc. The state can no longer bear the growing fiscal drain on account of loss-making departments.

Attracting Investment (Domestic and Foreign Direct Investment): Nagaland State must facilitate business investment by streamlining regulations, facilitating business registration, and providing incentives to firms that make investments and generate employment. Infrastructure Development: The state may fund significant infrastructure initiatives in areas like electricity, transportation, internet connectivity, and social

infrastructure like education and healthcare. This has the potential to boost economic growth, draw in investment, and generate jobs.

Promoting Economic Diversification: To prevent the economy from becoming overly reliant on a single industry, the state must support the expansion of several businesses. This can strengthen the economy and open up new avenues for revenue collection.

Fostering Entrepreneurship and Small Business Development: It ought to assist entrepreneurs by endorsing initiatives such as Startup India and Skill India. These initiatives can simplify regulations, offer funds, networking opportunities, and mentorship.

Strengthening State Public Sector Enterprises: It must improve the efficiency of state-owned enterprises in order to boost their earnings.

Monetizing Underutilized Assets: In order to generate income, state assets that are not being used efficiently must be made available through privatization or Public Private Partnerships (PPP).

Creating Non-Tax Revenue Streams: It should look for additional sources of income, like charging for public services, insisting on Government's (promotor) share of profits from state-owned enterprises, or leasing or selling government property.

Using Data Analytics: It must establish specialized data analysis teams to research ways to enhance tax collection, particularly in sectors that significantly contribute to the state's revenue.

Leveraging Central Schemes: To stimulate the economy and encourage infrastructure development, it should make use of capital assistance programs and initiatives like PM's Gati Shakti.

Promoting Tourism: Since the tourism sector generates tax income from sales and excise taxes, VAT, service taxes, hotel stays, and transportation, the state must nurture and grow it. Additionally, funds from tourism can be utilized to enhance welfare initiatives and infrastructure.

Examining Performance-Based Grants: States ought to seek out federal grants that incentivize enhanced revenue collection and fiscal restraint.

5.4.2 Expenditure

The State needs to allocate a greater share of its total expenditure to development priorities. Higher development spending, especially in productive sectors, is vital for breaking the cycle of dependency, fostering sustainable growth, and improving quality of life. This shift will require ongoing fiscal reform, budgeting discipline, and robust institutional support to ensure resources drive long-term, inclusive progress.

The state must manage its public spending effectively over the long run by employing various strategies to boost revenue, reduce expenses, manage funds responsibly, be transparent, and make prudent investments. The state also must ensure putting efficiency and cost management into practice. This entails reducing wasteful spending on things like subsidies and overhead. Nagaland should concentrate on making investments in sectors that support economic growth and infrastructure at the same time. Spending is linked to particular objectives through the use of outcome-based budgeting, and waste is prevented through improved financial management. Adopting transparency and budgetary responsibility: To maintain discipline, Nagaland should abide by rules pertaining to financial responsibility. Being transparent entails providing timely budget updates, adhering to financial regulations set forth by FRBM Acts and Finance Commissions, and routinely assessing how things are progressing. Tighter control over borrowing above the budget and potential future obligations is also crucial.

Seeking assistance from the national government and encouraging collaboration between states: The state may request additional funds from the federal government for several purposes. Additionally, it can use central programs to improve infrastructure and the economy. It might also be beneficial for other states to share their knowledge and best practices for managing finances.

5.4.3 Handling Debt

Strategies for managing debt in Nagaland that work.

Nagaland has varying debt levels. Effective debt management is critical to their long-term economic growth and financial stability. The state can accomplish this in the following significant ways:

The Fiscal Responsibility and Budget Management (FRBM) Act's goals for fiscal discipline must be adhered to by Nagaland: This entails limiting fiscal deficits in order to prevent excessive borrowing.

It must reduce revenue deficits: States that continue to have revenue deficits may have to borrow money only to cover interest, which exacerbates their financial issues. Focusing on earning enough money to meet expenses - excluding grants for asset creation - is crucial. Using money sensibly means identifying and reducing wasteful expenditure and allocating funds to profitable ventures.

Increasing sources of income

Enhance tax collection: To more efficiently collect taxes such as motor vehicle taxes, property taxes, and registration fees, Nagaland must leverage technology. This will increase compliance and decrease tax evasions.

Extend the tax base: It must identify new revenue streams that are appropriate for the state's unique circumstances, such environmental taxes or fees for traffic congestion. In order to maximize revenue, it must also examine current tax exemptions and subsidies.

Boost non-tax revenue: To increase non-tax revenue, State Public Sector Enterprises (SPSEs) must run efficiently and sell or lease underused state assets and services.

Appropriate borrowing methods

Strictly limit borrowing: This keeps people from taking on too much debt and ensures that borrowing is within the state's means of repayment.

Enhance the debt structure: Long-term borrowing should be prioritized in order to lower the likelihood of having to refinance and maintain a stable debt status. It must also take into account tactics like modifying the debt's terms and negotiating interest rates to obtain reduced rates.

Invest in profitable projects: The State must ensure that borrowed funds are mostly utilized for capital expenditures in sectors that spur growth and yield future returns, such as education and infrastructure, rather than for spending or subsidies.

Encouraging economic expansion

Invest in productive sectors: To support economic growth, Nagaland must make investments in areas including infrastructure, education, skill development, and export promotion.

Ease of doing business: In order to expand the tax base and enhance revenue, it should foster an atmosphere that is conducive to private investment and industrial expansion.

Fostering transparency and accountability

Be transparent about finances: In order for the public to hold leaders responsible and make educated decisions, the State must notify them about the amount of debt the Government borrows and the implications for the next generation.

Regularly report and evaluate: To identify issues and opportunities for improvement, it shall monitor the state agencies' and local bodies' financial status and performance.

5.5 Conclusion

Nagaland's future economic growth is closely tied to the state's fiscal policy decisions. With a heavy dependence on central government transfers and significant structural constraints, how Nagaland reforms its fiscal strategy will play a decisive role in stimulating growth, enhancing resilience, and addressing development gaps. The trajectory of Nagaland's future economic growth will depend on its ability to reform fiscal policies: strengthen domestic resource mobilization, rationalize expenditure, and improve public financial management. Successful reforms can drive sustainable growth and reduce vulnerability, but fiscal indiscipline or poor spending choices risk perpetuating low growth and central dependence.

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