



ORIGINAL RESEARCH PAPER

Economics

Goods and Services Tax: Ladder to Prosperity or Dream Selling

KEY WORDS: Compliance, Productivity, Distortions

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ABSTRACT

All governments in democratic setups wish to pursue policies of development with social inclusion. Taxation is the most important tool available to governments to pursue their agenda. The debate regarding the reform of tax system is contentious and ongoing. Various developing countries have tried different tax regimes with varied rates of taxes. This paper looks at various means through which GST is expected to affect the Indian industry namely, productivity gains via removal of distortions, easier compliance for small and medium enterprises, easier movement of goods across regions and cutting down on bureaucratic discretion and hence red tape. The paper then looks at how the introduction of GST will affect the black economy in India and how relevant this reform is for the poorer section of the society.

Introduction

All governments in democratic setups wish to pursue policies of development with social inclusion. Taxation is the most important tool available to the government to pursue their agenda. Taxation policy has the potential to dictate the path the economy must take and is the chief determinant of the resource mobilisation for the government. The Goods and Service Tax is being sold by the Government of India as the most important reform in the economy of independent India. This paper tries to analyse the different means through which this legislation can affect the economic agents and economic setup in the country and how significant it is for the Government of India to be able to improve upon their social welfare policies.

Tax reform and Economic Growth

The debate regarding tax reform and economic development is contentious and ongoing. However, there seems to be some agreement that very high tax rates are not particularly good for the economy. Literature shows that very high personal income tax and corporation tax is most harmful for the economy, very high consumption tax rate, slightly less so. The dilemma facing developing countries today is that they have to support both economic growth and redistribution via tax collection at the same time. If they focus on economic growth first and introduce lower tax rates then millions will be deprived of the most basic necessities of life like health and education. If they introduce high tax rates to finance public services then they risk stifling industry and the economy. Various developing countries have tried different tax rates facing this dilemma.

One way of looking at the issue is that the governments of the developing world may follow a high tax – high investment regime, with the investment being in the area of human capital. Health, Education and Sanitation have been considered as investment in human capital by a majority of development economists. However, the gestation period associated with such investment can vary in length.

GST and India's Expected Productivity Gain
Productivity Improvement via Removal of Distortions

Distortions have crept in the supply chain in the Indian economy as a result of differences in taxation regimes of different states. The simplest example of such taxation induced distortions is fuel stations across but close to state borders. If VAT on fuel is increased in state A making fuel expensive than available in neighbouring state B, fuel stations in border areas of state A go out of business. This is because it is very convenient for purchasers of fuel to cross over from State A to State B and purchase fuel there. The fuel pumps have to shift location only on account of tax differences. Similarly, a host of producers choose location with primary consideration being state tax regimes while other factors being neglected at times. With the introduction of Goods and Services Tax, the differences in state tax regimes is expected to disappear (although it will remain in petroleum for some more time) and

location of production units is expected to be decided by more important factors like availability of raw materials, suitable workforce etc.

Easier Compliance for Small and Medium Enterprises

Under the current regime, any production unit has to file a number of returns after carefully studying a plethora of rules and regulation. The studying of the complex web of rules and regulation is an expensive exercise that small and medium enterprises have to undertake. This constraint, along with other constraints such as difficulty in obtaining credit makes business of small and medium enterprises unviable. Big business have the capacity to hire expensive tax consulting firms which are beyond the capacity of small and medium enterprises. It is expected that with the introduction of Goods and Service Tax, the complex system of rules of tax filling with the authorities will be made simpler, easing the burden on small and medium enterprises.

Easier Movement of Goods Across Regions

Supply chains in Modern economy require different components of final products and final products themselves to be produced at different locations and moved across regions for assembly. The difference in state tax regimes necessitates checking of documents at state borders across the country. If one asks a truck driver in India about the most difficult aspect of his job, the answer is not driving on poor quality roads but getting passed the check points. With Goods and Services Tax regime bringing uniformity in state taxation regimes, the check points are expected to disappear. This move alone will be a big boost for the industry since the number of days goods are in transit is a cost for the industry which will definitely come down.

Cutting Down on Bureaucratic Discretion and Hence Red Tape

The plethora of rules governing tax filling with the authorities and getting the papers verified at check points while the goods are in transit have one common side effect. It gives a lot of discretion to the inspectors/officials. Many a times, the businesses find it cheaper to bribe the officials than to try to follow the regulations. Also, the regulations governing tax fillings have come up as piece meal solutions to issues as and when they have been realised by the legislature. With the tax system being overhauled by Goods and Services Tax regime, there is expected to be much more clarity and consequent to that much less discretion for the inspectors/officials. This is expectation to cut down on red tape and make doing business much easier for all types and sizes of enterprises but especially for small and medium enterprises.

GST, Direct Taxes and Black Money

One sources of black money in the economy is when producers and traders sell the goods and don't pay indirect taxes. In such a situation, they conceal the income made from such transaction and that income ends up as Black Income. With the introduction of Goods and Services Tax, the loopholes which have been used by

traders and producers to avoid paying indirect taxes will disappear and PAN numbers will have to be linked with business fillings. The income made from business transactions then cannot be concealed and would have to be shown in their personal accounts making it necessary for the businessmen to pay direct taxes as well.

The Poor and the GST

The government of India has had a far lower than sufficient budget for Health, Education and Sanitation. One of the reasons for this is unavailability of funds with the government itself. If the economy grows faster as expected after the Goods and Services Tax comes into effect and with businesses paying their genuine share of indirect taxes and businessmen paying their share of direct taxes in their individual capacity then resource availability with the government will increase drastically making it that much easier for the government to increase outlays on social schemes for the poor.

Conclusion

Governments of developing countries all over the world are facing the dilemma of the optimum tax rates to simultaneously provide a boost to the economy and also collect resources to spend for the poor. All governments would like to spend for the welfare of the poor but are constrained by the availability of the resources. There have been instances where businesses have been paying not taxes but bribes for running their business. This leads to funds not entering government coffers but illicit private wealth creation and increasing inequality in the economy. Goods and Services Tax after blocking the loopholes available to the businesses and businessmen to avoid paying taxes, is expected to increase resource mobilization of government and make it viable for the government to pursue programmes for social welfare with significantly enhanced resources allocation.

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