GST: a contest of competing truths

A goods and services tax which is growth-oriented will improve the efficiency of the tax and the simplicity of its implementation

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Formulation of public policy, including tax policy, is often beset with the dilemma of competing truths. In most cases, policy cannot be easily formulated by exercising a choice between the "right" policy and the "wrong" policy. Instead, it is mostly forged by a contest between competing policies representing competing truths, each truth valid in its own sphere but each pointing to a different path. Different concerns and interests drive these competing truths. An example of such a contest being played out in the public space currently is the debate on Aadhaar. This debate represents the contest between the truth of the need for identity and focused and efficient social security to the poor versus the truth of the need to respect the privacy of all citizens. The debate on the structure of the goods and services tax (GST) represents another such contest. It can be seen as a contest between the risk-averse "GST must be revenue-neutral" truth and the forward-looking "GST must be growth-oriented" truth. This article examines the nature of these two truths and suggests how both can and should be accommodated in the formulation of GST policy.

'THE GST MUST BE REVENUE-NEUTRAL' TRUTH

This truth aims at protecting revenue, an important consideration. It also seeks to maintain the progressiveness of the GST by keeping a low rate of tax for items of mass consumption while taxing luxury and sin goods at higher rates. It is argued that items consumed by different segments of society need to be taxed differentially depending on income levels so that the poor are completely protected from the impact of the GST, while the rich pay their due share.

However, in the consequent determination of the GST policy, this laudable truth has been clouded by three other considerations. First, the impact of the proposed GST structure specifically on consumer price index (CPI) inflation. Second, the need to align the proposed GST structure with the existing indirect tax structure. Third, the need to raise resources for the payment of compensation to the state governments.

For assessing the impact on the CPI inflation, this methodology uses as a desideratum, the present base of Central and state indirect taxes (keeping out the items excluded by the GST). There are 300 items in the CPI basket. The combined incidence of Central and state tax on about 50% of the basket weight is less than 3%. Further, 9% of the basket weight is levied a tax of between 3% and 9%, 22% of the basket weight is charged between 9% and 15%, 8% of the basket weight is charged between 15% and 21%, and about 11% of the basket weight is charged at above 21%.

The rates presently applicable on these different basket weights in the existing tax regime are sought to be mirrored in the proposed GST structure, so that there is no impact on CPI inflation. Thus the proposed structure will have about 50% of the basket weight (92 items) exempt, 9% of the basket weight (29 items) charged at 6%, 20% of the basket weight (71 items) charged at 12%, 8% of the basket weight (37 items) charged at 18%, 6% of the basket weight (50 items) charged at 26%. About 9% of the basket (21 items) remains outside the GST. This will effectively be a six-rate structure, i.e. exempt, zero, 6%, 12%, 18% and 26%.

These six rates will be applied differentially on the 300 items in the CPI basket and, of course, on items outside the CPI basket. It is then estimated that the impact of the GST on the CPI will be nearly zero, with marginal increases in the indices of health, fuel and light, clothing and footwear, food and beverages being compensated by corresponding decreases in the other indices. A separate rate of 4% for gold is also reportedly under consideration. Including the integrated GST (IGST) rate (which will be a separate classification based upon the inter-state nature of sales), this may bring up the number of rates to eight. This is apart from the cesses for generating revenue for meeting compensation demands from states which are sought to be levied on items like coal, peat, lignite (environmental cess) and tobacco. In addition, it is proposed to continue the National Calamity Contingent Duty (the NCCD was, interestingly, termed a duty of excise in the Finance Bill) for the funding of the National Disaster Response Fund. The NCCD schedule lists 101 categories of items on which excise is levied at four rates, namely 1%, 10%, 23% and 45% (apart from the specific duties on cigarettes). These items include cigarettes, tobacco, *paan* masala, *zarda*, mobile phones, vehicles, cars, three-wheelers, motorcycles, scooters and mopeds. If these four NCCD rates are taken into account, the number of rates applied in the proposed GST regime will go up to 12! Correspondingly, the number of product differentiations will also be 12. It is indeed commendable that the GST has been tailored not to fuel inflation, but there are other ways of addressing this problem other than creating a multiple-rate structure. Since the IGST will be levied on imports, reduction of customs duty could be one such option, reducing the level of protection and, hence, prices.

This truth—that the GST must be revenue-neutral—is indeed very relevant and valid but essentially backward-looking. Also, concerns on the effect of GST specifically on CPI inflation, as well as the need to continue with the NCCD have clouded this truth, generating a 12-rate structure with attendant classification issues, rent-seeking opportunities and a complex operational structure. A one-page GST return—a worthwhile objective under any system—seems impossible under this structure.

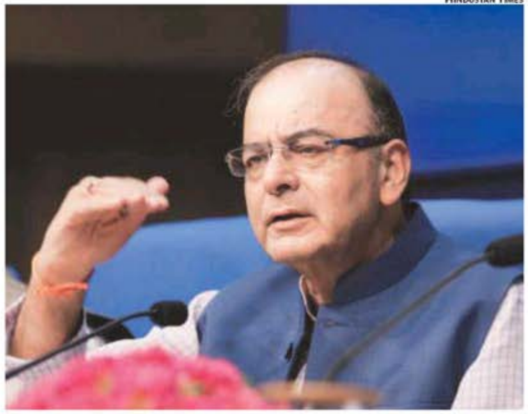
'THE GST MUST BE GROWTH-ORIENTED' TRUTH

This truth seeks to leverage the efficiency of the GST to accelerate the growth of the economy between 0.9% and 1.7%. It seeks to make industry more competitive and induce productivity gains through lower costs and more efficient procurement and logistics. It also seeks to improve indirect-tax compliance and, through a ripple effect, enhance direct-tax compliance. A one-page GST return is very possible under this structure

Essentially, this truth is anchored in Saptapadi. It involves taking the following seven steps.

First, apply the broadest possible base to the GST and allow very few exemptions. All such exemptions should be driven purely by public policy concerns like the need to bolster health and education in the country.

Second, apply a single rate on this extended base. The rate as computed by the task force of the Thirteenth Finance Commission was 12%, with 7% being the state GST rate and 5% being the Central GST rate. This would be a good place to start.



The concern of GST being revenue-neutral is valid but essentially backward-looking. It will create a 12-rate structure with attendant classification issues and rent-seeking opportunities

Third, leverage the existing Jan Dhan Yojana, Aadhaar and Mobile Number (JAM) mechanism to directly support the poor on whom the single rate on essential commodities would have an adverse impact. Assume an additional impact of about Rs2,000 per annum on every poor person due to the single-rate GST. The Rangarajan committee identified the total number of poor in India in 2011-12 at 360 million. Assuming this number has remained the same today, the total requirement of subsidy would be Rs72,000 crore. This would represent only about half of the 1% increase in gross domestic product (GDP) derived from implementing such a broad-based and comprehensive GST. If the average family size is taken as 4.5, the transfer amount will be Rs9,000 for a poor family per annum. This amount can be transferred directly in quarterly instalments in advance to the head of the eligible family.

The Unique Identification Authority of India (UIDAI) has reported that Aadhaar has already covered 93% of all adults in the population and more than 1 billion people so far. It will soon be ready to provide the biometric identification base to state governments for categorizing all their BPL (below poverty line) families. State governments could be charged with the job of identification of BPL families based on nationally agreed poverty distribution numbers. The 550 million savings bank account holders and the 600 million mobile phone users (acting both individually as well as in concert) can enable poor households to directly access this subsidy efficiently, cost-less-ly and promptly. Such an approach will also herald the direct income support schemes which are being espoused for vulnerable categories like farmers apart from the poor.

Fourth, levy special cesses outside the GST framework on all demerit goods. Different rates may be levied on different goods, but this levy, being outside the GST, will not be eligible for input tax credit. They will be kept distinct and separate from the GST and will not be reported in the GST tax return. These special cesses will be levied concurrently with single-rate GST and will provide an additional revenue source from luxury, sin and environmentally harmful goods.

Fifth, enable an automatic single-point registration of all dealers (both new as well as those transiting from the value added tax/Central excise system) through GSTN (GST Network) for all GST-related levies, i.e. Central GST, state GST, and integrated GST. However, state and Central governments should be empowered to cancel summarily such automatic registration in their respective jurisdictions, in case irregularities are discovered on physical inspection of the dealer's premises, within a specified period subsequent to such automatic registration.

Sixth, put in place an instrumentality for sharing a portion of the GST revenue with the third tier of government i.e. municipalities and panchayats. This will enable the fulfilment of the promise of the 73rd and 74th amendments—the creation of a third level of vibrant democratic governments. Urban areas are and will continue to be the engine of GDP growth. Municipalities need to be assured of a stable and buoyant source of funding to effectively provide services to residents and promote economic growth.

Seventh, and finally, given that much of the GST will be a leap of faith, it would be desirable for the GST council to review the structure proposed above after a specified period, say three years, so that necessary adjustments can be made, if required.

CONCLUSION

There are four stakeholders in the GST arena. These are consumers, industry, state governments and the Central government. All four will be affected by the GST, though in different measures. The consumer is looking for the lowest and least complex tax, since in the consumption-based GST, she is the one who will pick up the final tab. Industry is looking for a simple GST which will reduce its cost of compliance while improving its operational efficiency. State governments may be relatively indifferent to the structure given the overly generous compensation packages offered by the Centre. The Centre is keen to protect its revenue, minimizing the impact on CPI while seeking funding for providing compensation.

The "GST must be revenue-neutral" truth is essentially a valid truth but its concomitant objectives will result in the creation of a complex and bloated tax structure which may not address the concerns of either industry or the consumer. The "GST must be growth-oriented" truth has only one objective. As Arjun saw only the eye of the bird, this truth sees only the trigger to enhance growth, the efficiency of the tax and the simplicity of its implementation. It addresses the concerns of both the consumer and the industry.

Of these two competing truths, which is the encompassing truth, which addresses all the concerns of the impact of the tax, without diluting its growth momentum, its efficiency and its effectiveness? Clearly, it is the "GST must be growth-oriented" truth, and it is to this truth that we must commend India's indirect-tax destiny.

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