GST Council should seize the initiative

While rolling out GST, it must ensure that the taxation policy is transparent, predictable and inclusive

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Let me now turn to the final, but to my mind, the most important reform in the Indian fiscal federal framework. This relates to the successful implementation of the GST... The recent passage of the GST Constitutional Amendment [and] the ratification by 17 states... have demonstrated the ability of our political parties to be bipartisan. The GST Council so created by the constitutional amendment is a landmark event in the history of India's fiscal federalism.

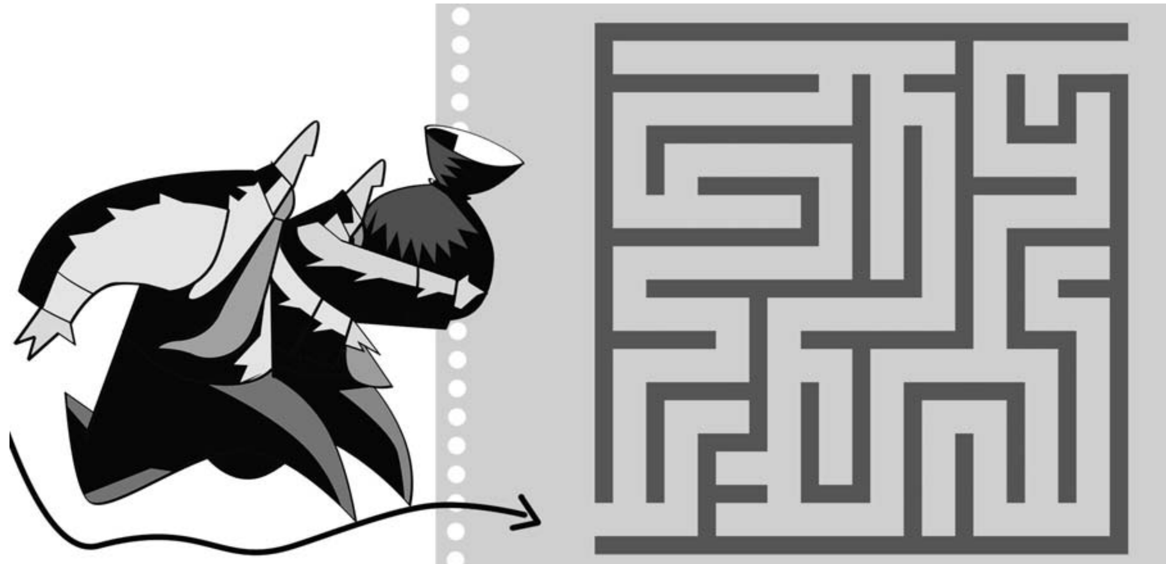
The Centre and states from being good fiscal neighbours will now become equal fiscal partners in sharing a common indirect tax base. While this is by no means a perfect grand bargain — electricity duties and taxes on real estate continue to be outside the purview of GST — it embodies the desired reform with the objective of creating a single Indian market in substantive measure. And yet this is only the beginning and a lot remains to be done. In this endeavour the newly created GST Council will indeed be decisive.

It would perhaps be prudent to follow the empowered committee system to sort such things out in a time-bound manner outside the full council. Whereas compensation to the states for five years is now a done deal, there is scope to decide the extent of compensation. A full compensation will create a perverse incentive for the states and lead to their not exerting enough to collect the tax revenues in an efficient fashion. To avoid such an adverse outcome, a tapered form of less than full compensation is the way forward.

Yet another issue that needs to be decided upon upfront has to do with the precise form and content that will comprise the delegated legislation. Whereas delegation may solve some specific problems for some states it will be at the cost of the very national character of the GST. The council needs to ensure that as far as possible there is a convergence of incentives amongst states, which further means that there is consensus on the right compensation formula and minimising delegated legislation.

As the GST roll-out happens we need to keep in mind that taxation policy has to be transparent, predictable and inclusive. This alone can maximise the favourable impact of the GST on investment and growth. There are sweeping powers vested with the GST Council not unlike a regulator, who also arbitrates. This makes it even more essential that the changes and deliberations are put out as discussion papers and real consultations with the public take place.

And then there is an important issue of capacity building. Let us ensure that the GST Council will be a 21st century institution with digital empowerment and digital processes. Can we hope that it will be our first paperless institution? This council will need human resources as well as technical facility of high order. Having such capabilities should be the GST Council's first priority.



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The commitment to a shared tax structure across the Indian union, the end of cascading, the institutional approach to taxing the consumption of Indian citizens commonly wherever they reside are all features of a truly national single market that will bind the federation by removal of man-made barriers to the consumption of goods and services across the country. This will of course bring improvements in efficiency but will also promote inclusive and equalising growth.

The central government has outlined its proposal for the GST rate structure. To me, the approach outlined by the authorities signals a disappointing beginning, which well could have been otherwise; a thundering take-off to "shock and awe" the domestic and international community and capital markets. I feel that the approach adopted by the authorities robs the GST of its efficiency enhancing potential. This is due to several reasons: Multiple rates varying from four per cent to 26 per cent; different rates for goods and services; high rates at the retail level; leaving out the infrastructure sector such as construction, immovable assets; multiple registration forms and manual reconciliation for all refunds.

Consequently, the growth impact on the economy will be only one-fourth of the high potential impact that the 13th Finance Commission had estimated; high compliance costs arising out of different rates and these also leading to classification disputes; lower compliance levels due to the rates going up to as high as 26 per cent at the retail level; potential slackening of tax efforts by the states due to promised 100 per cent compensation of the shortfall.

I am afraid that all these difficulties may surface rather sooner than later. Growing adverse reactions due to the unfolding of these problems will, I am sure, persuade the authorities to change its approach and follow a path more like the one outlined by the 13th Finance Commission and once again seize the initiative on stimulating growth and equity.

I have no doubt that we will eventually move from "one nation, one tax" to "one nation, one tax, one registration and one rate" and I am sure this single rate will be closer to 12 per cent. I am reminded by what Sir Winston Churchill said about the United States as this is relevant to other large democracies such as India. He said, "The United States of America finally does the right thing but only after trying all other alternatives".

The writer is chairman, National Institute of Public Finance and Policy. Based on edited excerpts of the Shankar Aiyar Memorial Lecture. The series is concluded. The first part appeared on Wednesday