

Introduction

The role of taxation in influencing the choice of location of industries and flow of trade is well recognised. However, the form and content of the impact of taxation on location and regional economic development remains a controversial issue. Existing literature and available information do not enable any definitive judgement about the effects of variations in tax or subsidies on industry location or diversion of trade to a particular region. The question assumes importance in the context of the creation of the National Capital Region (NCR).

The area of the NCR comprises the Union Territory of Delhi, as its core, and contiguous parts of three neighbouring States, viz., Haryana, Uttar Pradesh and Rajasthan (Exhibit 1A). The constituent units of each sub-region are as follows:

- a. Haryana sub-region (13,413 sq. kms) comprising (i) Faridabad district; (ii) Gurgaon district; (iii) Rohtak district; (iv) Sonapat district; (v) Rewari and Bawal Tehsils of Mahendragarh district; and (vi) Panipat tehsil of Karnal district;
- b. Uttar Pradesh sub-region (10,853 sq. kms) comprising three districts, viz. (i) Meerut; (ii) Ghaziabad; and (3) Bulandshahar;

- c. Rajasthan sub-region (4,493 sq. kms) comprising six tehsils of Alwar district, namely, Alwar, Ramgarh, Behror, Mandawar, Kishangarh and Tijara; and
- d. The Union Territory of Delhi (1,483 sq. kms).

As the delineated area for the NCR covers a limited number of districts from the neighbouring States, differences in tax structure of two States can create distortions that would not arise elsewhere. These distortions occur because tax difference which might be too small to change the behaviour across the wide geographical areas becomes much more important within a narrow region, such as along the State borders. Therefore, most of the studies on taxes and economic behaviour will be largely irrelevant for such limited geographical areas.¹

The present study seeks to identify what seem to be policy issues relevant to the framing of a viable tax policy for the NCR. It also outlines the conditions under which adjustments in tax policy may have a positive effect on the regional economic development. This would be in consonance with the basic objectives of the NCR Plan, which envisages rational development of Delhi and a balanced development of the region. For this purpose, it proposes dispersal of economic activities over self-contained regional towns, restructuring of the regional transport network and integrated development of land and infrastructure.²

¹Recent research has shown that differential tax structures do affect the level of retail activity along the State borders. See, Fox, William F. (1986), "Tax Structure and the Location of Economic Activity along State Borders", *National Tax Journal*, Vol. 39, No. 4, December, pp. 387-401.

²Town and Country Planning Organisation (1974), *Regional Plan, National Capital Region*, New Delhi.

Objectives of the Study

Balanced regional development requires an examination of a host of aspects relating to taxation as well as public expenditure, especially concerning infrastructure. However, the objectives of this study are limited to the following aspects:

- a. Examination of the tax structure of the States comprising the NCR with special reference to sales tax, taxes on motor vehicles and goods, octroi, local property tax, and electricity duty;
- b. Analysis of the built-in incentives in the existing tax structure and their effects on industrial location and concentration of commerce and trade in specific regions;
- c. Formulation of a new tax structure to provide necessary incentives to achieve the objectives of dispersal of industrial and commercial activities; and
- d. Discussion of policy implications of suggested tax structure.

Within the framework of the above objectives, the tax policy and other fiscal measures proposed in this study could go a long way in fulfilling the objectives of the NCR.

Plan of the Study

The plan of the study is as follows: Chapter 2 reviews the set of considerations relevant in evaluating the effects of various tax policy changes. Chapter 3 is a brief review of the practices in various States and local areas falling within the purview of the National Capital Region (NCR). Empirical analysis of the effects of tax policies on location of industry and on diversion of trade, with supportive evidence, is presented in Chapters 4

EXHIBIT-1A



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and 5, respectively. A concluding section sums up by discussing the conditions under which harmonisation of tax policies could be conducive to the economic development of the NCR.

Many important aspects relating to urban economic development are not covered in this study. Because the subject of this inquiry is limited to the commodity tax policy of the sub-national (viz., State and local) governments, we do not consider tax policies of and incentives given by the Central Government for urban economic development. The scope of this study is further narrowed by the exclusive concern with tax policies, to the neglect of public expenditure, capital subsidies and other devices which the State and local governments may use to develop infrastructural facilities to attract industry.