Securing Fiscal Resources for Development Expenditures

China and India: Sustaining High Quality Growth
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** All opinions expressed in this presentation are those of the author and should not be attributed to any other individual, institution or government unless otherwise stated.*

Fiscal Performance

	2005-06/ 07-08	2008-09/09-10	2010-11	2011-12	2012-13 BE
(% to GDP)					
1. Revenue Receipts	10.1	9.3	10.3	8.6	9.2
2. Tax Revenue (net to centre)	8.1	7.5	7.4	7.2	7.6
3. Non-Tax Revenue	2.0	1.6	2.8	1.4	1.6
4. Capital Receipts	3.7	6.6	5.3	6.2	5.5
Of Which					
5. Borrowings and other liabilities	3.3	6.3	4.9	5.9	5.1
6. Total Receipts	13.9	15.8	15.6	14.8	14.7
7. Non-Plan Expenditure	9.9	11.0	10.7	10.0	9.5
8. Plan Expenditure	4.0	4.8	4.9	4.8	5.1
9. Total Expenditure	13.9	15.8	15.6	14.8	14.7
10. Revenue Deficit	1.8	4.9	3.3	4.4	3.4
11.Fiscal Deficit	3.3	6.3	4.9	5.9	5.1
12. Primary Deficit	-0.2	2.9	1.8	2.8	1.9
Growth of GDP					
Real (Constant Market Prices)	9.5	6.1	9.6	7.5	
Nominal (Market Prices)	15.4	13.8	18.8	16.1	14.0*
Real (Constant Factor Cost)	9.5	7.6	8.4	6.9	7.6*

Source: Union Budget 2012-13

* Budget projection

Fiscal Consolidation

	2008-09/09-10	2010-11	2011-2012	2012-13 BE
		(Δ % to GDP)		
1) Tax Revenue (net to centre)	-0.87	0.36	-0.22	0.38
2) Non-Tax Revenue	-0.13	1.05	-1.45	0.22
3) Capital Receipts**	-0.19	-0.05	-0.13	0.08
4) Total Consolidation of Revenue Side	-1.18	1.35	-1.79	0.68
		(Δ % to GDP) -1		
5) Non-Plan Expenditure	-0.50	0.50	0.65	0.46
6) Plan Expenditure	-0.30	-0.24	0.15	-0.34
7) Total Consolidation of Expenditure Side	-0.79	0.26	0.81	0.12
8) Fiscal Deficit (7+4)	-1.97	1.61	-0.99	0.80
9) Primary Deficit	-0.32	1.36	-0.95	0.86

Notes:

1) + Tighten / - Loosen

**2) Does not include receipts in respect of Market Stabilization Scheme and excludes Borrowings and other Liabilities

Expenditure Consolidation

	2008-09/09-10	2010-11	2011-12	2012-13 BE
	(Δ % to GDP) -1			
Non-Plan Expenditure				
1 Interest Payments & Debt Servicing	0.07	0.25	-0.04	-0.06
2 Defence Expenditure	-0.18	0.19	0.09	0.01
3 Subsidies	-0.38	-0.07	-0.17	0.56
4 Pensions	-0.19	0.12	0.12	0.01
5 Police	-0.06	0.05	-0.02	0.02
6 Other Non-Plan Expenditures	0.26	-0.03	0.67	-0.08
Total	-0.49	0.51	0.65	0.46
Plan Expenditure				
On Revenue Account	-0.23	-0.16	0.21	-0.25
On Capital Account	-0.07	-0.08	-0.06	-0.09
Total	-0.30	-0.24	0.15	-0.34

Break-up of Subsidies

	2008-09/09-10	2010-11	2011-12	2012-13 BE
		(Δ % to GDP) -1		
Fertiliser Subsidy	-0.17	0.14	0.06	0.15
Food Subsidy	-0.14	0.07	0.02	0.08
Petroleum Subsidy	-0.09	-0.27	-0.27	0.34
Interest Subsidies	0.01	-0.02	0.00	-0.01
Other Subsidies	-0.01	0.01	0.03	0.00
Total – Subsidies	-0.40	-0.07	-0.16	0.56

Tax Effort

	2008-09/09-10	2010-11	2011-12	2012-13 BE
	(Δ % to GDP)			
Gross Tax Revenue				
1 Corporation Tax	-0.04	0.10	-0.22	0.00
2 Taxes on Income other Corporation Tax	-0.09	-0.09	0.06	0.00
3 Customs	-0.40	0.48	-0.05	0.12
4 Union Excise Duties	-0.44	0.20	-0.11	0.22
5 Service Tax	-0.07	0.02	0.14	0.16
6 Other Taxes	-0.09	-0.05	-0.04	0.00
Total	-1.12	0.66	-0.22	0.50

INDIA: VAT/GST Reform

- India has been on the reform mode since 1986 when VAT principle was initiated on selected commodities at the Centre up to manufacturing stage (as per Constitution). Subsequently, the number of tax rates and their dispersion were reduced; the VAT principle was extended to an increasing number of commodities; in 1995, a positive list of 5 services was introduced to be taxed at a lower rate; the rate and number of services were brought up over the years, and input tax credit between goods and services was featured.
  - At state level, after a decade of preparation from 1998, a VAT on goods was introduced in 2005, from manufacturing stage forward. A distortive tax on interstate trade continues, but is being phased out.
  - A broader Goods and Services Tax (GST), running in parallel at the Centre and state levels, was planned for April 1, 2010. Progress towards a robust, meaningful structure has been in fits and starts. GST introduction is awaited.

Emergence of VAT

- In December 1995, (Congress Government), in a conference called by the Union Finance Minister, he asked state Finance Ministers to study then distortive state taxes (Sales Tax) on domestic goods and services (perhaps a VAT?) including a tax on interstate trade (CST).
- In December 1996, a Task Force submitted its first report on phasing out Central Sales Tax (CST).
- Subsequently, state Chief Ministers formed an Empowered Committee of State Finance Ministers to consider introduction of a VAT – EC (VAT).
- In 2002 (Government of Bharatiya Janata Party BJP), in a conference of EC (VAT), announced introduction of VAT in all States from April 2003. They agreed on a minimum set of common features in every State VAT legislation.
- A model VAT structure was circulated to all States.
- It was agreed that CST would be phased out.
- Except Haryana (a special case), all other states postponed the implementation of VAT, however, in the last minute, with impending general elections.

Reasons for Non-Introduction of VAT in the First Round

- All states were not adequately prepared. Some states were hurrying through their VAT legislation in state Assemblies even in the last week of March.
- It was apprehended by the traders that a VAT would increase their paper work and was more complicated.
- The proposed VAT would replace Sales Tax and some minor taxes like Work Contract Tax, Lease Tax, Turnover Tax and Luxury Tax. However, Octroi, a distortionary tax on entry, tax on selected services and State Excise Duties would continue, making the reform incomplete.
- Traders apprehended that prices of certain products would rise, e.g. medicines and drugs, due to increase in their effective tax rates.
- Revenue gains would be uneven among states.
- With the above, the anticipated benefits did not match up to the political economy of VAT introduction.

The Second Round: VAT's Introduction

- A Congress-led government was elected in April 2004.
- In January 2005, EC (VAT) completed a White Paper on VAT—at rates of 4% and 12.5%, with a common base and exemption list and a short pool of differentiated exemptions of local importance.
- On April 1, 2005, State VAT was introduced. Opposition states ruled by the BJP, did not.
- Revenue growth from VAT was 25% p.a. as opposed to 12.5% from Sales Tax for 5 years prior to VAT introduction.
- A phenomenal example of fiscal federal co-operation as the Centre assured a formula based compensation for revenue loss based on the previous best 3 years' revenue (17.5% p.a.) for 3 years.
- While most states experienced revenue gain, some large manufacturing states lost but were compensated, resulting in the Centre's giving out the budgeted funds for compensation.
- Eventually all states introduced VAT reflecting its revenue productivity.
- An important cause was the extension of the tax base to traders/retailers from (effectively) manufacturing.
- The next phase was a Centre-state agreement to phase out tax on inter-state trade (Central Sales Tax).
- CST rate (from 4% to decline by 1% p.a.) would reach 0% by April 1, 2010, when a Goods and Services Tax (GST) would be introduced. But it still continues at 2%.

Goods and Services Tax (GST)

- The final phase of reform is the GST, originally planned to be introduced on April 1, 2010.
- In December 2007, a GST committee recommended a two-chain GST for the Centre and states covering both goods and services and with the input tax credit principle.
- There would be no credit across the Centre and state chains since that would imply anomalous revenue ramifications between them where revenue sharing is determined by the Finance Commission quinquennially per the Indian constitution.
- Details are still being negotiated between the two levels of Government, while the essential structure has been endorsed by both.
- Chairman of the State Finance Ministers' Empowered Committee resigned after losing election in his state, and his portfolio. The new Chairman is from the BJP. Further movement is awaited.

Some of the Lacunae in GST Design

- Two independent debit-credit channels—centre and state—for the GST are proposed: CGST and SGST. Each stream will cover all goods and services.
- The tax rate(s) on goods and services are to be decided. Not having the same tax rates for goods and services would be a major lacuna since classification problems would soar—in contrast to an ideal GST.
- The GST base would exclude petroleum products and alcoholic beverages, a major lacuna in contrast to global GST systems.
- CST will be abolished and GST on interstate trade will be monitored with a clearing house based in the banking system—though IT support is awaited. Revenue loss of states from CST abolition will be compensated by the centre.
- A VAT Council chaired by the central finance minister with states having a supporting role will decide changes in GST structure, challenging federalism principles at one extreme.
- Decisions will be by consensus. This is a lacuna since, at another extreme, the slightest opposition would stall progressive change.