

GST: One more NDA Failure*

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July 2018 marks the first month of the second year in which the much-heralded Goods and Service Tax (GST) regime has been in place. When launched 13 months earlier, in a propaganda blitz that (wrongly) claimed that this “one nation, one tax” system was a game-changer, the government had promised that the new regime would help the Centre and the states to efficiently mobilise the resources needed to put India on a high growth trajectory. In fact, demonetisation and the GST regime were presented as the two initiatives of the Modi government that would transform India.

Demonetisation, as the government’s own numbers provided in the Reserve Bank of India’s latest Annual Report establish, has been a failure from the point of view of stated objectives such as freezing and rendering worthless black wealth held as cash, preventing counterfeiting and encouraging a shift away from cash to digital transactions. And now it is becoming clear that GST is proving a failure too. In fact, from the beginning of its implementation it was clear that the new tax regime was not what it was claimed to be. To start with, it had to be accepted that a regressive flat or single tax on all commodities, whether consumed by the rich or the poor, was unviable in a country with India’s low average income and extreme inequality. After much negotiation, the nation has been given a structure with seven rates varying from zero to 28 per cent (0, 0.25, 3, 5, 12, 18 and 28 percent). In the case of goods and services produced and sold in the same state, these rates are split between a central tax and a state tax. There is also a cess on sin and luxury goods to mobilise resources that compensate states for loss of projected revenue due to a shift to the new regime for a period of five years. This multi-tax structure does not simplify the system too much, and only promises to do away with the cascading effects of the erstwhile excise duties and sales taxes.

Given these different GST rates, the GST Council is constantly subject to pressures to shift commodities and services to lower tariff groups. Governments are not always strong enough to resist such pressures, as was evident from a July 21 decision to reduce rates on “non-essential” commodities such as washing machines, refrigerators, vacuum cleaners and cosmetics. Adjustments of this kind combined with the flawed nature of the GST have meant that the new regime is not delivering the promised revenues, and the division of revenues raised between the Centre and the states favours the former.

Thirteen months is time enough for the much-hyped experiment with the new taxation regime to stabilise, allowing for an assessment of its efficacy and procedural simplicity. The numbers suggest that the performance of the new tax is more than just disappointing, but in fact fiscally damaging. The most recent such evidence is with respect to GST collections in August relating to transactions in July. The Finance Ministry reports that collections stood at Rs. 93,960 crore for that month. This is not just lower than the Rs. 96,483 crore collected in June, but way below the peak collection of Rs. 1,03,5459 crore recorded in April 2018.

The government has, of course, underplayed the July decline, arguing that it is the result of a postponement of purchases that would have occurred when consumers

waited to benefit from the reduction in GST rates for more than 50 commodities (varying from washing machines and refrigerators to paints and sanitary napkins) announced by the GST Council on July 21. But the lowered rates were applicable as early as July 27, so there was a period of just around a week when the old rates were still applicable even though the new rates had been announced. Indian buyers, traders and producers are smart enough to accept orders and execute them as soon as the new rates became applicable. So GST collections for the month need not have fallen just because of those delayed transactions. Moreover, monthly GST collections had been rising over April to June, so that a minor shortfall in late July would have been more than neutralised if that rising trend in collections had been sustained.

Overall, revenue generation from GST has been far short of expectations. The government's own pruned target for average collections for fiscal year 2017-18 was Rs. 91,000 crore. The actual collections during the first 8 months of the new regime were Rs. 7,41,000 crore, making for a monthly average of Rs. 89,885 crore, which was more than Rs. 1,000 crore short of target every month. The monthly average target for 2018-19 has been set at Rs. 1,00,000 crore, while the average realisation during the first five months of the current financial year is Rs. 96,706 crore. In fact there has been only one month in the thirteen for which figures are available when GST collections exceeded Rs. 1,00,000 crore.

One claim of the government was that the shift to GST would be revenue neutral. Clearly, therefore, the targets being set must reflect that perception. Hence, if these targets have not been met then it should be because the new tax is not revenue neutral in practice. This, argues Kerala Finance Minister Thomas Isaac (in a forthcoming book on the threat to fiscal federalism), affects the states more adversely than it does the Centre. Under the erstwhile regime, the volume of past tax revenues from sources now subsumed under the GST, suggested that indirect taxes were split in a 60:40 ration between the states and the centre respectively. However, in negotiations over the split of the GST rate between the Centre and the states, the former managed to manoeuvre a 50:50 split, at the expense of the states. Combine that with the fact that doing away with cascading also reduces tax collections in the aggregate, and a fall in revenues mobilised, or 'non-neutrality', is inevitable. This has extremely adverse implications for state governments for two reasons. To start with, the fall in revenues accruing to the states is damaging inasmuch as the states have given up their individual autonomy to set indirect tax rates on those commodities that have been subsumed under the GST. They cannot compensate for the loss through their own actions. Second, these indirect tax revenues are far more important for the overall receipts of the states than of the Centre, as the states have far fewer alternative sources of buoyant revenue to make up for the loss.

This may not be a problem immediately because states have been promised compensation for any shortfall in revenues for a period of five years. But once that time period is completed, the shortfall relative to trend would manifest itself in receipts. The size of the shortfall relative to projections factoring in a 14 per cent increase in revenues every year starting with base year 2015-16 can be large, going up to 30-40 per cent in the case of some states according to reports. Given the magnitudes involved, despite the promise of compensation, states already face a stringent resource shortfall problem because of delays in the transfer of compensation payments on the part of the Centre. States are compensated for their revenue losses

once every two months, with the payment transferred in middle or latter part of the following month. This creates a cash crunch for many states, forcing them to borrow in the market and incur an interest burden, which worsens their financial position.

Other anomalies have arisen as well. Thus, while states were facing a cash crunch, huge amounts of money were accumulating and lying unused in the Integrated Goods and Services Tax (IGST) fund, with the sum at one point amounting to around Rs. 2 lakh crore. When a good moves across state borders it is subjected to IGST. Traders in the state making the purchase pay this to the Centre. But this payment consists of a central and state component, with 50 per cent accruing to the state where the tax is finally borne by the consumer. On sale to the consumer who is charged the indirect tax as well, the trader claims credit for the IGST payment made earlier and does not transfer the tax shown in that transaction either to the state or central government. But the claim establishes to which state government the Centre would have to transfer the 50 per cent state component in the IGST earlier collected. Since the transactions involved are stretched over time, some accumulation of taxes in the IGST fund is inevitable. But as the states have been quick to point out, accumulation of the magnitudes observed in practice is unjustifiable, and reflects inefficiencies in the system, which penalises the states without reason. The Centre has had to acknowledge this problem, and make temporary allocations of a part of the IGST funds, with these advances being adjusted against actual dues of the state when recognised.

These kinds of distortions abound, made worse by the fact that the reporting system under the GST is extremely complex and cumbersome and the privately run GST network not in proper working order. States complain that with the system not permitting clear matching of claims of tax credit with actual transactions, there has been a huge leakage of revenues generated. Actual tax collection is far short of what is potentially possible even under the new regime.

Finally, despite this revenue loss, the consumer has not benefited. Taking account of all duties and sales taxes imposed prior to the GST, the average indirect tax burden on non-essential goods has been estimated at between 30 and 40 per cent under the earlier regime. This has been brought down quite significantly with the shift to the GST. Many of these commodities are now subject to an 18 per cent rate or less, without any cascading effects of taxes at multiple points. Yet prices of goods and services have not come down. Taxes implicitly charged are in excess of even the potential. So prices have not come down providing consumers with some benefit from the new regime. On the other hand revenues have shrunk. All this is evidence enough to establish the GST as just one more failure of badly conceptualised and implemented policy under the current BJP-led government.

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