GST Reform to Aid Economic Recovery*

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The economic indicators show steady progress in the recovery process. Although the core sector growth continues to be muted, both manufacturing and service sector PMI indexes have shown a significant rise in April 2023 indicating a steady expansion of activities in these sectors. The manufacturing PMI increased to 57.2 as compared to 56.4 in the previous month, and this was the highest in the last 4 months. The Services PMI increased to 62 which was a 13-year high. The offtake of non-food credit increased by 9.7% on March 25, as compared to 4.5% a year ago. The economy is estimated to have grown by 7% in the last fiscal and is expected to register a growth of 6.5% this year. The CPI inflation rate at 5.66% in March 2023 has come below the upper threshold of the flexible inflation target of 6% and the Monetary Policy Committee projects the rate at 5.2% in FY 24, and this has prompted the RBI to take a pause in hiking the rate. With the deceleration in both exports and imports, the current account is within the manageable threshold.

The elevated levels of deficits and debt, however, continue to be a challenge that needs to be addressed. The combined fiscal deficit of the Union and State governments in 2023-24 is budgeted at close to 10% of GDP. In addition, there are off-budget liabilities and although the Union government has brought most of them into the budget, these liabilities are considerable at the State level, and liabilities arising from the power distribution sector alone would work out to 1.5-2% of GDP. Given that the household sector's financial saving is just about 8.5-9% of GDP, the large draft on them by the Union and State governments leaves very little borrowing space for the private sector and as their borrowing costs increase, the investment recovery gets adversely affected. Besides, at the Central level, the interest outgo by the government is almost 40% of its revenues as the debt to GDP ratio has escalated to 84% of GDP. Therefore, it is extremely important for both the Union and State governments to bring down their fiscal deficit and debt expeditiously.

Thankfully, the tax revenues have been buoyant and there are indications that the buoyancy seen in the last year will continue. This can help in faster fiscal consolidation. In fact, the revenue from both GST and income taxes have shown high growth rates last year. The preliminary actuals show that the net revenue collection of income taxes increased by 17.5% and the growth in GST was 21.7% in 2022-23 over the previous year. In fact, the high GST increase comes on the back of 29.5% growth in the previous year. Although it is too early to make a prediction, if the trend continues the actual revenue collections would exceed the budget estimates considerably to help in fiscal consolidation and allocation of the larger volume of resources to capital expenditure.

After almost six years of implementation, the GST seems to be settling in. There has been a steady improvement in collections after the pandemic subsided. This is not only due to the recovery in the economy but also due to better compliance with the tax due to improvements in tax administration. As the technology platform is firmed up, compliance has improved as there is better detection of tax evasion through fake invoicing. The record collection of Rs. 1.87 trillion in April marks a new high in the monthly collections and it is higher than the next highest collection of Rs. 1.67 trillion in April 2022. Of course, the collections in the month of April tend to be higher as this actually reflects the businesses conducted in March, and a lot of year-end clearing and settlement is concluded. The collection of revenue in April this year is higher than last year's by 12%. Consi9dering the revival of economic activities, there are reasons to believe that revenue collections in the succeeding months would be significantly higher than the correcting months of the previous year. Although it will take time and significant second-generation reforms to make GST really a "money machine" as it has happened in many countries, the reform is settling down and holds promise.

Considering the elevated levels of fiscal deficit and public debt, the second-generation reforms in GST should be initiated sooner than later. The reforms are best done when the economic recovery is underway, and revenues are becoming more and more buoyant. Pruning the exemption list will help to expand the tax base and the objective of equity is better done by increasing the threshold. It is better to 'focus on whales rather than minnows' to raise revenue productivity. The number of taxpayers with less than Rs. 50 lakh turnover constitutes over 93%, and their tax contribution is just about 10%. It is important to reduce the number of rates to two (if not one) and it is possible to work out a revenue-neutral way to achieve that. Items under 12% and 18% contribute 75% of the tax. Merging the two rates to 15%, raising the 5% category to 8%, and doing away with 28% altogether, if not pruning this only to 'demerit goods' could be considered. This would also help in the recovery process as items under the 28% category include construction materials and passenger cars. Bringing in petroleum products and electricity within the ambit of GST is equally important from the viewpoint of making the tax comprehensive and imparting export competitiveness. The time is opportune for such an overhaul, and this will not only improve revenue productivity but also help in the economic recovery process.

**** Views are personal.***

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