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Globalization, the State, and India's Halting March to Common Market: The Political Economy of Tax Reform Under Federalism

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Abstract

As a social phenomenon, globalization has been the target of much criticism. One particular line of attack holds that it will lead to the segmentation and disintegration of the national economy. However, an examination of the long process of reform of the indirect tax system in India underlines, paradoxically, the significant role of globalization precisely in fostering domestic economic integration in the form of a common market, which would overcome the economic segmentation existing prior to globalization. Interestingly, such tax reform has, in considerable part, been driven by the need to meet globalization's challenge that India's economy be efficient and internationally competitive. At the same time, one should not underestimate the critically important role of the state as an institutional variable—which critics tend often

to ignore—in carrying through the goal of establishing a common market, presently a work still in progress.

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Notes

1. Prabhat Patnaik, The Retreat to Unfreedom: Essays on the Emerging World Order (New Delhi: Tulika Books, 2003), pp. 42–3; Paul Streeten, “Paradoxes of Globalization,” in Jonathan M. Harris and Neva R. Goodwin, eds., New Thinking in Macroeconomics: Social, Institutional, and Environmental Perspectives (Cheltenham UK: Edward Elgar, 2003), Chapter 4.

2. Government of India [hereafter GoI], Finance Ministers’ Budget Speeches, 1947 to 1996 (New Delhi: Lok Sabha Secretariat, 1996), Vol. II, p. 1294. As I have shown elsewhere, it was, again, concerns about economic efficiency that were uppermost in Mrs. Indira Gandhi's turning away from the public sector and socialism; see Baldev Raj Nayar, Globalization and Nationalism: The Changing Balance in India's Economic Policy, 1950–2000 (New Delhi: Sage, 2001), pp. 115–16.

3. M. Govinda Rao, “Raja Chelliah: Father of India's Tax Reforms,” Business Standard, April 9, 2009. Accessible via http://www.business-standard.com. See also S. L. Rao, “Father of Tax Reforms,” The Hindu, June 22, 2010. Accessible via http://www.hindu.com.

4. Raja J. Chelliah, Towards Sustainable Growth: Essays in Fiscal and Financial Sector Reforms in India (Delhi: Oxford University Press, 1996), pp. 147–8.

5. M. Govinda Rao, “Tax System Reform in India: Achievements and Challenges Ahead,” accessible at http://www.econ.hit-u.ac.jp/~kokyo See also M. Govinda Rao and R. Kavita Rao, “Trends and Issues in Tax Policy and Reform in India,” in Arvind Panagariya and Suman Bery, eds., The India Policy Forum 2005–06 (New Delhi: Sage Publications, 2006), pp. 55–122; and M. Govinda Rao and R. Kavita Rao, “Tax System Reform in India,” in Roger H. Gordon, ed., Taxation in Developing Countries: Six Case Studies and Policy Implications (New York: Columbia University Press, 2010), pp. 109–50.

6. Rao, “Tax System Reform,” p. 6: “raising more resources and achieving the desired state of redistribution became an obsession and this caused the policy-makers to design the income tax system with confiscatory marginal rates.” The excessive emphasis on progressiveness was not a characteristic merely of India; it was a feature of the postwar period in the US and Great Britain as well; see Rao and Rao, “Trends and Issues,” pp. 61–2.

7. See also GoI, Tax Reforms Committee, Interim Report (New Delhi: Ministry of Finance, 1991), p. 15.

8. Rao, “Tax System Reform,” p. 7.

9. Policy-makers had become aware of the deficiencies of the tax system even in the 1970s and made scattered and hesitant—but valiant for the time—efforts at reform. A more Herculean, though protracted and still incomplete, attempt at systematic reform had to await economic liberalization in the 1990s. See Rao and Rao, “Trends and Issues,” pp. 66, 108, 118.

10. Chelliah, Towards Sustainable Growth, p. 148.

11. Rao, “Tax System Reform,” pp. 5, 20.

12. Chelliah, Towards Sustainable Growth, pp. 148–9.

13. Empowered Committee of State Finance Ministers, First Discussion Paper on Goods and Services Tax in India (New Delhi: November 10, 2009), p. 5. Accessible at http://finmin.nic.in

14. Cited in Rao, “Tax System Reform,” p. 19.

15. Rao, “Tax System Reform,” pp. 3, 20.

16. Rao, “Tax System Reform,” pp. 22–3.

17. Chelliah, Towards Sustainable Growth, p. 7.

18. Rao and Rao, “Trends and Issues,” pp. 58–61.

19. Rao and Rao, “Trends and Issues,” p. 118.

20. Rao, “Tax System Reform,” pp. 9–10.

21. GoI, Tax Reforms Committee, Interim Report, p. 38.

22. GoI, Tax Reforms Committee, Final Report: Part I (New Delhi Ministry of Finance, 1993), p. 6.

23. GoI, Tax Reforms Committee, Final Report, pp. 5, 36, 171–2.

24. Parthasarathi Shome, “India: Resource Mobilization through Taxation,” in Peter S. Heller and M. Govinda Rao, eds., A Sustainable Fiscal Policy for India: An International Perspective (New Delhi: Oxford University Press, 2006), pp. 197–8.

25. GoI, Tax Reforms Committee, Interim Report, pp. 1–2, and Final Report: Part I (New Delhi: Ministry of Finance, August 1992) and Final Report: Part II (New Delhi: Ministry of Finance, January 1993). Apart from the chairman, the other members were: S.V. Iyer, V.U. Eradi, Amaresh Bagchi (who resigned in December 1991 to join the World Bank), and V. Rajaraman.

26. GoI, Tax Reforms Committee, Interim Report, p. 108, and Final Report, p. 3.

27. GoI, Tax Reforms Committee, Final Report, pp. 36, 172.

28. GoI, Tax Reforms Committee, Final Report, p. 45.

29. GoI, Ministry of Finance, Department of Revenue, Final Report of the Expert Group on Taxation of Services (typescript, 2001), pp. 21, 26.

30. On the differentiation between the two types of federalism, see M. Govinda Rao and Nirvikar Singh, The Political Economy of Federalism (New Delhi: Oxford University Press, 2005), p. 152.

31. GoI, Tax Reforms Committee, Interim Report, p. 108; emphasis added.

32. This and the next three paragraphs are based on National Institute of Public Finance and Policy, Reform of Domestic Trade Taxes in India: Issues and Options: Report of a Study Team (New Delhi: NIPFP, 1994), pp. xx–xxiii, 19.

33. M. Govinda Rao, “Think TIN, Not Just GST,” Business Standard, March 21, 2010. Accessible via http://www.business-standard.com

34. Empowered Committee of State Finance Ministers, A White Paper on State-Level Value Added Tax (New Delhi: January 17, 2005), p. 3. Accessible via http://www.tinxsys.com

35. Yashwant Sinha, Confessions of a Swadeshi Reformer (New Delhi: Penguin/Viking, 2007), pp. 128–9

36. Sinha, Confessions, p. 129.

37. Empowered Committee, A White Paper, p. 4.

38. Sinha, Confessions, p. 129.

39. See GoI, Planning Commission, Report of the Advisory Group on Tax Policy and Tax Administration for the Tenth Plan (New Delhi: Planning Commission, May 2001). Accessible via http://planningcommission.nic.in Other members of the group were: N. J. Kurian, D. K. Srivastava, Sukumar Mukhopadhyay, D. B. Lal, and Pawan Aggarwal. Shome had served with IMF and also as Director of NIPFP (1995–97). He has worked in many Latin American and African countries. He is the recipient of Brazil's highest civilian award for a non-citizen: Commander of the Order of the Southern Cross.

40. Empowered Committee, A White Paper, p. 14.

41. Empowered Committee, A White Paper, p. 13.

42. Empowered Committee, A White Paper, p. 16.

43. Shome, “India,” p. 211.

44. GoI, Planning Commission, Report of the Advisory Group, pp. 20, 197.

45. GoI, Planning Commission, Report of the Advisory Group, pp. 20–21, 197–8.

46. GoI, Ministry of Finance, Report of the Task Force on Implementation of the Fiscal Responsibility and Budget Management Act, 2003 (New Delhi: Ministry of Finance, July

2004), pp. 44, 48. Accessible via http://finmin.nic.in

47. GoI, Ministry of Finance, Report of the Task Force on Implementation of Fiscal Responsibility, p. 49.

48. GoI, Ministry of Finance, Report of the Task Force on Implementation of Fiscal Responsibility, pp. 72–4, 153, 158.

49. For a comprehensive guide to the issue, see the extensive study by D.K. Srivastava and Bhujanga C. Rao, “Taxation of Goods and Services in India,” in GoI, Commission on Center-State Relations, Supplementary Volume II: Research Studies (New Delhi: 2010).

50. GoI, Ministry of Finance, Report of the Task Force on Implementation of Fiscal Responsibility, pp. 72–3; emphasis added.

51. GoI, Ministry of Finance, Report of the Task Force on Implementation of Fiscal Responsibility, pp. 153–5, 161.

52. “A Model and Road Map for Goods and Services Tax in India – Views of the Empowered Committee of State Finance Ministers,” New Delhi, April 30, 2008, cited in Thirteenth Finance Commission, Report of the Task Force on Goods & Services Tax (New Delhi: December 15, 2009), p. 3. http://fincomindia.nic.in.

53. Empowered Committee, First Discussion Paper.

54. Empowered Committee, First Discussion Paper, p. 8.

55. Empowered Committee, First Discussion Paper, pp. 13–24.

56. Thirteenth Finance Commission 2010–2015, Volume I: Report, pp. 64–5.

57. Thirteenth Finance Commission 2010–2015, Volume I: Report, pp. 64–5.

58. Thirteenth Finance Commission, Report of the Task Force on Goods & Services Tax (New Delhi: December 15, 2009), p. 3. Accessible via http://fincomindia.nic.in The task force had seven members, four of whom were administrators: Arbind Modi (IRS), Joint Secretary, Department of Revenue (chairman); V. Bhaskar (IAS), Joint Secretary, TFC; B.S. Bhullar (IAS), Joint Secretary, TFC; Dr. Rathin Roy, Economic Advisor, TFC; Dr. Ajay Shah, Senior Fellow, NIPFP; Dr. Kavita Rao, Senior Fellow, NIPFP; and Ritvik Pandey (IAS), Deputy Secretary, TFC.

59. Thirteenth Finance Commission, Report of the Task Force, pp. 119–20.

60. Thirteenth Finance Commission, Report of the Task Force, pp. 112–3.

61. Thirteenth Finance Commission, Report of the Task Force, p. 114.

62. Thirteenth Finance Commission, Report of the Task Force, pp. 3, 114, 120.

63. Thirteenth Finance Commission, Report of the Task Force, p. 5.

64. Thirteenth Finance Commission, Report of the Task Force, p. 85.

65. Thirteenth Finance Commission, Report of the Task Force, p. 103.

66. Thirteenth Finance Commission, Report of the Task Force, p. 105.

67. This section draws on news reports in the contemporaneous daily press and individual discussions with V.N. Alok, Sanjaya Baru, Mythili Bhusnurmath, Saumitra Chaudhuri, Swapan Dasgupta, Ravi Dhingra, P. Vaidyanathan Iyer, Ashok Malik, Dhiraj Nayyar, Amitabha Pande, K.C. Pant, Kavita Rao, M. Govinda Rao, and Pronab Sen, among others, during November and December 2010.

68. Jaideep Mishra, “A Muse for Tax Design,” Economic Times, July 28, 2010. Accessible via http://www.economictimes.com

69. R. Kavita Rao, “Goods and Services Tax: The 13th Finance Commission and the Way Forward,” Economic and Political Weekly, Vol. 45, No. 48 (November 27, 2010), pp. 71–7. Accessible via http://epw.in

70. Dhiraj Nayyar, “FM Gives in Too Easily on GST,” Financial Express, July 25, 2010. Accessible via http://www.financialexpress.com

71. Comment, “GST Gridlocked,” Times of India, December 8, 2010. Accessible via http://www.timesofindia.com

72. Vrishti Beniwal, “Consensus on GST Still a Distant Dream,” Business Standard, October 21, 2010. Accessible via http://www.business-standard.com

73. Desperate to get the long-delayed process of implementation going, the center in March 2011 introduced in parliament an amendment to the constitution to empower both the center and states to levy GST in place of the existing indirect taxes. This occurred after the states found, for one reason or another, three earlier proposals on

the amendment unacceptable. The amendment authorizes the establishment of (1) a GST council, consisting of the finance ministers of the center and states, which will make decisions by consensus on tax rates and exemptions; and (2) a GST dispute resolution authority, presided over by a judge, to decide on disputes between the center and states and among the states. The hope is to introduce GST on April 1, 2012.

The amendment suffers from several weaknesses insofar as it would, in an attempt to assure the states, constitutionally exempt petroleum and related fuels, alcohol, and real estate—which would contribute considerably to cascading of taxes—as well as octroi and entry taxes, which would segment the common market. Perhaps, these concessions may assuage the states enough to ease adoption of the amendment. See Satya Poddar, “GST Bill: A Sub-optimal Outcome,” Business Standard, March 23, 2011. Accessible via http://www.business-standard.com

See also Vivek Pachisia, “GST Bill – Diluted and Disappointing,” Hindu Business Line, April 9, 2011. Accessible via http://www.thehindubusinessline.com The amendment's adoption, however, faces an uphill task in that it needs to be passed by two-thirds majority of both houses of parliament and by at least 15 of the 28 state assemblies, about nine of which are presumed to be opposed to the introduction of GST.

74. Thirteenth Finance Commission, Report of the Task Force, p. 112.

75. Chelliah, Towards Sustainable Growth, p. 89.

76. GoI, Ministry of Finance, Task Force Report on Indirect Taxes: Final Report on Indirect Taxes (New Delhi: Ministry of Finance, 2002), paragraph 1.2. While this report is no longer available on the internet, the paragraphs cited here are the same as in GoI, Ministry of Finance, Consultation Paper: Task Force on Indirect Taxes (New Delhi: October 2002). Accessible via http://www.gstindiablog.com

77. GoI, Ministry of Finance, Task Force Report on Indirect Taxes, paragraph 2.3.

78. GoI, Ministry of Finance, Task Force Report on Indirect Taxes, paragraph 2.7.

79. GoI, Ministry of Finance, Report of the Task Force on Implementation of Fiscal Responsibility, pp. 53–4, 153.

80. Highly conscious of the need for a common national market, the founding fathers of India's constitution included a separate section on interstate commerce, Article 301 which states: “trade, commerce and [commercial] intercourse throughout the territory

of India shall be free." See Durga Das Basu, Introduction to the Constitution of India (13th ed.; New Delhi: Prentice-Hall of India, 1991), p. 315. However, qualifications and reservations to the article allowed decision-makers to segment the economy. Interestingly, nonetheless, Justice P. B. Gajendragadkar proclaimed the article, while delivering the majority opinion in one Supreme Court decision, to be essential to India's economy, to advancing the living standards of its people, and to the economic unity of the country, which was in turn necessary for strengthening political unity. See H. M. Seervai, Constitutional Law of India: A Critical Commentary (Third ed.; N.M. Tripathi Private Ltd., 1984), Vol. 2, pp. 2155–6.

81. Chelliah, Towards Sustainable Growth, pp. 13–4.

82. Chelliah, Towards Sustainable Growth, pp. 15, 18; emphasis added.

83. Chelliah, Towards Sustainable Growth, pp. 202, 212–3.

84. GoI, Tax Reforms Committee, Interim Report, p. 1.

85. GoI, Tax Reforms Committee, Interim Report, p. 17.

86. GoI, Tax Reforms Committee, Interim Report, pp. 40–41.

87. GoI, Tax Reforms Committee, Final Report: Part I, p. 7.

88. NIPFP, Reforming Domestic Trade Taxes, p. 1.

89. GoI, Ministry of Finance, Report of the Task Force on Implementation of Fiscal Responsibility, p. 157; emphasis in the original.

90. GoI, Ministry of Finance, Report of the Task Force on Implementation of Fiscal Responsibility, p. 157.

91. GoI, Planning Commission, Report of the Advisory Group, pp. 195, 204.

92. Thirteenth Finance Commission, Report of the Task Force, p. 4.

93. Thirteenth Finance Commission, Report of the Task Force, p. 94, and also p. 118.

94. Thirteenth Finance Commission, Report of the Task Force, p. 36.

95. Thirteenth Finance Commission, Report of the Task Force, p. 31.

96. Thirteenth Finance Commission, Report of the Task Force, p. 70.

97. Thirteenth Finance Commission, Report of the Task Force, p. 71.

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