Tax hikes need to be utilized judiciously for sustained economic recovery

As India's GDP growth shows signs of recovery, other indicators such as GST revenues also signify improvement in economic activity over the past few months. The higher GST collections can also be attributed to the government's efforts to curb tax evasion, apart from overall improvement in the economy.

However, the Fifteenth Finance Commission has suggested that the 12 per cent and 18 per cent slabs under GST be merged into one standard rate, and GST be rationalized to a three-rate structure. The Commission has assessed that the effective tax rate under GST stands at 11.8 per cent, which is lower than 14 per cent, the average revenue neutral rate that was required for the smooth transition from the value-added tax regime without any revenue loss.

The report examines that annual GST losses equal Rs 4 trillion on account of lower rates. This is equivalent to the current amount of GST collected by the Centre. While GST accounts for about one-third of the gross tax revenues of the Central government, it constitutes about 44 per cent of state tax revenues.

Further, taxes and duties account for about 60 per cent of the retail prices of petrol and diesel in India. While the recent hikes in fuel prices can be attributed to rising international crude oil prices, cesses account for about 70 per cent of the Central government's taxes on fuels, and these are not shared with states.

In a year when COVID-19 battered the economy, and the Centre and states incurred huge expenses to keep the economy afloat and meeting the bare necessities of the underprivileged, both the Central and state governments are trying to mop up tax revenues.

However, higher taxes can stoke inflation and crunch demand which is detrimental for economic growth. Further, if higher tax revenues are not used towards capital expenditure such as infrastructure creation, they can further dampen growth.

While the Central government has committed to higher infrastructure spending in its Union Budget 2021, at a time when private investments are not coming forward due to the uncertainties created by the COVID-19 crisis, the same should be implemented in letter and spirit for sustained economic recovery.

Notifications

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