



Transcript of podcast with Arvind Subramanian: “India’s New Tax Breaks Down Old Barriers”

May 30, 2018

Hello, I’m Bruce Edwards and welcome to this podcast produced by the International Monetary Fund. In this program: Arvind Subramanian talks about some of the benefits of a new tax for India’s economy.

MR. SUBRAMANIAN [soundbite]: *Now, we’re able to get a better handle on the size of the informal and the formal sectors in India in a way that we could never do before.*

As economic adviser to the government of India, Arvind Subramanian helped design the country’s goods and services tax (GST). In July of last year, the national GST replaced a patchwork of value-added sales and excise taxes levied by 29 states and the federal government. In this interview with the IMF’s Chris Wellisz, which is also featured in the [June 2018 edition](#) of *Finance & Development* magazine, Subramanian says the tax helped remove some of the internal trade barriers within India, creating a single internal market for the first time since independence.

MR. WELLISZ: Mr. Subramanian, let me ask you: when you were appointed Chief Economic Adviser in 2014, you were already a strong advocate of the GST. But, that’s an idea that had been debated for quite a long time. What were some of the obstacles you faced in winning over state governments?

MR. SUBRAMANIAN: Two or three big challenges came from the states. One, of course, the loss of sovereignty. Because remember, earlier they used to levy these taxes in various forms and they had complete freedom to do so. And now it would all be jointly decided by the central and the states. So, there is a real sense in which they lost—although lost would be too extreme a word. They had to partly relinquish sovereignty and then pool that sovereignty with everyone else.

A second reason, which I think was also important, was the kind of independence, or freedom that they had, they could also use to attract investments to their own states. For each state government that was very valuable, but for the country as a whole it led to a race to the bottom.

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MR. WELLISZ: So, originally when you arrived in office, you were arguing quite forcefully for two rates; a very simple structure for the GST. You ended up with six, which, I think, many economists say is not really optimal because it is more complex.

MR. SUBRAMANIAN: In principle, everyone bought into the view that it had to be simple. But, the politics of that was such that every state—if you think about it, 29 plus 1: 30 entities out there—each state had its own kind of political compulsion. One state was a producer of some good, and even though it was a public consumption tax, they would say: well, charge that at a lower rate. Unfortunately, politics required that we had to depart from this simple three-rate structure—we got into many rates.

But then, the interesting thing that happened was that once it was implemented, there was a high rate, a 28 percent slab. People realized that was leading to a lot of evasion; it was too high, and the GST Council—which is the forum that deliberates on this—then started paring down the 28 percent rate. So, some progress was made after the implementation. It is still true that there is still some way to go, and I'm hoping that over time simplicity will be achieved—over two to three years or so.

MR. WELLISZ: And what about the exemptions? There are some important exemptions like petroleum, alcohol? Do you hope to bring those in?

MR. SUBRAMANIAN: Yes, exactly. So, there are a number of products kept out of it—alcohol is a big one. I think that going forward, I'm very hopeful that certainly electricity and real estate and petroleum will at some stage be brought in. But, the way I think it is going to work—and the Finance Minister has said this very clearly—is that we're still waiting for the whole GST to stabilize. We're not quite sure how buoyant the revenue take will be. So, once it stabilizes, I think we will have a better sense that we're comfortable, there is adequate revenue, and then we can bring in some of these things into the GST. Over time that will happen.

MR. WELLISZ: Now, the GST was introduced shortly after another major innovation which was far more controversial, namely the demonetization. That caused a lot of economic disruption that has been blamed for a slowdown in economic growth. Were you concerned that launching the GST so soon after demonetization would compound those problems and to what extent were your fears realized?

MR. SUBRAMANIAN: Yes, I think there was concern that the GST coming close on the heels of demonetization, I mean, they were like two major policy disruptions as it were. And, we did see a slowdown in growth in 2017. But, towards the end of last year, those two shocks seemed to be behind us, and the economy has started to recover again.

But, there is no question that there were transitional impacts from those two policy experiments. And, also because in some ways, both those policy experiments affected the informal sector, in particular—because the GST meant that part of compliance improving means that those who are outside the tax net do face a cost. And certainly, demonetization

had an impact on the cash intensive and therefore the informal sector. So, not only were there two kind of policy destructive shocks, but they impacted the same set of economic actors.

MR. WELLISZ: And you mentioned bringing people into the tax system, out of the gray economy presumably into the formal economy. How big an impact do you expect that to have on government finances?

MR. SUBRAMANIAN: I'm very optimistic about that. In fact, we have some early evidence. We've seen, for example, in the GST that there has been an almost 50 percent increase in the number of registered GST taxpayers. Essentially, I think we are going to see, or are already seeing, an increase in taxpayer registration which will lead to better compliance over time. Our conservative estimate is that once it stabilizes, we should get another 1 to 1.5 percent of GDP extra revenue from the GST.

It is going to be a unique system, possibly one of the few VAT systems around the world, where you're going to get this matching of what the supplier says he sold to a buyer and what the buyer says he has bought from the supplier. Once that matching happens, then you can try and reduce the evasion and the lack of compliance.

MR. WELLISZ: What about the economic impact in the long term, in terms of growth, employment, investment? Is it possible at this stage to assess what that would be?

MR. SUBRAMANIAN: One huge impact of the GST is going to be that barriers to the movement of goods and services within India are going to come down. So, we expect this huge increase also in trade within India, and that's like a tariff cut, in a sense. So, that should also add to trade and growth as well. And then, of course, that should generally make the Indian economy a much more attractive place to invest in.

MR. WELLISZ: And to what extent have these benefits, do you think, been diminished by the complexity of the tax?

MR. SUBRAMANIAN: I do think that some of the benefits you get from simplicity and transparency do get undermined. But, I think that this is something that the GST Council is acutely aware of, and over time, I'm hopeful that they will work on it and try and chip away at some of the complexity.

MR. WELLISZ: Do you think there should have been a bigger effort to test the GST before it was rolled out? I ask that because there have been reports that exporters have complained that it has taken them quite some time to get reimbursements.

MR. SUBRAMANIAN: You know, there is never a right moment to implement something as vast and as complicated as this. I think that maybe some things, preparations, could have been better in some respects—the IT aspect and so on—but that's not the way the real world and politics work. You have to seize the moment. Therefore, what is important is not whether you're well prepared or not, but whether you have systems that can respond to the problems.

MR. WELLISZ: Do you see this somehow meshing with advances in banking and electronic payments? There have been big advances in India on that front as well.

MR. SUBRAMANIAN: Yes, I think one of the big collateral benefits from this is going to be financial inclusion. Because, for example, a lot of small and medium enterprises don't have easy access to credit because they don't have documentation, they don't have a track record. So, now what the government is trying to do is: the tax payments that are made electronically can be discounted and you can create a market for bills and create a backbone where these people can better access credit.

So, the whole financial inclusion credit access for the small guys—you know, the big guys always have access over the small guys—based on the electronic paper trail that the GST provides could have enormous benefits as well.

MR. WELLISZ: Speaking of the electronic paper trail, you said that the GST has taught you things about the economy that you didn't know before. What have you learned from this?

MR. SUBRAMANIAN: Until the GST became available, we hadn't known what was the exports of each of the states, because India is a vast country, so individual states wanted to know how much they export internationally, and there was no way of knowing until we did this exercise.

The other thing was, now we're able to get a better handle on the size of the informal and the formal sectors in India in a way that we could never do before. So, quite apart from the tax side and the cooperative federalism boost, just the information that we're going to get to be able to better understand the economy and hence, provide inputs into policy making, is going to be quite huge.

MR. WELLISZ: Next year the government faces elections. Is there a risk that concessions will have to be made or that improvements will have to be postponed during this political season?

MR. SUBRAMANIAN: I think that if the GST Council succumbs to this kind of populism, it will have negative impacts on the long run functioning of the GST. I think there is enough of a collective spirit in the GST Council that populism can be avoided.

MR. EDWARDS: That was Arvind Subramanian, chief economic adviser to the government of India, talking with Chris Wellisz. Their [conversation](#) is featured in the June 2018 edition of *Finance & Development* magazine. The magazine is available online at imf.org/fandd, or you can download the *Finance & Development* app to read it on your mobile device.

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