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A Market, Unified

Arvind Subramanian explains the advantages of a new tax for India's economy and budget

AS CHIEF ECONOMIC ADVISOR to the government of India starting in 2014, Arvind Subramanian helped design the country's goods and services tax (GST). In July 2017, the nationwide GST replaced the patchwork of value-added, sales, and excise taxes levied by 29 states and the federal government. The GST was introduced less than a year after demonetization, the government's controversial move to remove 86 percent of currency from circulation.

In this interview with *F&D's* Chris Wellisz, Subramanian, who previously served as assistant director of the IMF's Research Department, discusses how the tax created a single internal market for the first time since independence in 1947.

F&D: What were some of the obstacles to persuading state governments to support the tax?

AS: One, of course, was the loss of fiscal sovereignty. 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 center and the states. They could also use tax incentives to attract investment. For each state government that was very valuable—but for the country as a whole, it led to a race to the bottom.

F&D: Initially, you argued for a very simple structure for the GST. You ended up with six rates, which many economists say is not optimal because it is more complex.

AS: In principle, everyone bought into the view that it had to be simple. But... each state had its own political compulsions. One state was a producer of some good, and they would say, well, charge that at a lower rate. Unfortunately, politics required that we had to depart from this simple three-rate structure.

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 progress was made. There is still some way to go, and I'm hoping that over time simplicity will be achieved.

F&D: Some significant sectors, like petroleum and real estate, are untouched by the GST. Do you hope to include them at some point?

AS: I'm very hopeful that certainly electricity, 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—we're still waiting for the whole GST to stabilize. We're not quite sure how buoyant the revenue take will be, but once it is, all those sectors can be brought in.

F&D: Were you concerned about launching the GST so soon after demonetization, which was blamed for a growth slowdown?

AS: Those two shocks seem 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.

F&D: Has the GST improved tax collection?

AS: There has been an almost 50 percent increase in the number of registered GST taxpayers. We are going to see 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 [value-added tax] 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 to reduce the evasion and the lack of compliance.

F&D: What about the economic impact?

AS: Barriers to the movement of goods and services within India are going to come down. So we also expect this huge increase in trade within India, and that's like a kind of tariff cut in a sense. That should also add to trade and growth as well and make the Indian economy a much more attractive place to invest.

F&D: Have these benefits been diminished by the complexity of the tax?

AS: Some of the benefits you get from simplicity and transparency do get undermined. This is something that the GST Council is acutely aware of.

F&D: Exporters have complained that it has taken them quite some time to get reimbursements. Should there have been a bigger effort to test the GST before it was rolled out?

AS: There is never a right moment to implement something as vast and as complicated as this. Preparation could have been better in some respects, but that's not the way the real world and politics work. You have to seize the moment. What

is important, then, is not whether you're well prepared or not, but whether you have systems that can respond to the problems.

F&D: How does this mesh with advances in banking and electronic payments?

AS: One of the big collateral benefits is going to be financial inclusion. A lot of small and medium enterprises don't have easy access to credit because

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they don't have documentation or a track record. So now the tax payments that are made electronically can be discounted, and you can create a market for bills and a backbone where these people can have better access to credit.

F&D: What has the introduction of the GST taught you about the economy?

AS: India is a vast country, so individual states want to know how much they export internationally. There was no way of knowing until we did this exercise. Also, we're now able to get a better handle on the size of the informal and the formal sectors in India in a way that we never could before. 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, providing inputs into policymaking, is going to be quite, quite huge.

F&D: Do next year's elections create a risk that concessions will have to be made or that improvements to the GST will have to be postponed?

AS: If the GST Council succumbs to this kind of populism, it will have pretty 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. **FD**

This interview has been edited for length and clarity.