Economic Survey 2017-18 [Chapter 2]: A New, Exciting Bird's-Eye View of the Indian Economy Through the GST

INTRODUCTION

- The GST has been widely heralded for many things:
  - Its potential to create one Indian market,
  - expand the tax base,
  - foster cooperative federalism,
  - it will create a vast repository of information, which will enlarge and surely alter our understanding of India's economy.
- **Some new findings from GST data:**
  - **Increase in number of indirect taxpayers:**
    - There has been a large increase in the number of indirect taxpayers.
    - Many have voluntarily chosen to be part of the GST, especially small enterprises that buy from large enterprises and want to avail themselves of input tax credits.
  - **Distribution of GST base among the states:**
    - The distribution of the GST base among the states is closely linked to their Gross State Domestic Product (GSDP).
    - It allayed fears of major producing that the shift to the new system would undermine their tax collections.
  - **Information on trade:**
    - New data on the international exports of states suggests a strong correlation between export performance and states' standard of living.
    - India's exports are unusual in that the largest firms account for a much smaller share than in other comparable countries.
    - Internal trade is about 60 percent of GDP, even greater than estimated in last year's Survey and comparing very favorably with other large countries.
  - **Information on formal and informal sector:**
    - India's formal sector non-farm payroll is substantially greater than currently believed.
      - Formality defined in terms of social security provision yields an estimate of formal sector payroll of about **31%** of the non-agricultural work force.
      - Formality defined in terms of being part of the GST net suggests a formal sector payroll of **53%** of the non-agricultural work force.
    - The size of the formal sector (defined as being either in the social security or GST net) is **13%** of total firms in the private non-agriculture sector but **93%** of their total turnover.

TAXPAYERS

- **Increase in number of registrants:**

  - As of December 2017, there were 9.8 million unique GST registrants, slightly more than the total indirect tax registrants under the old system.
  - But the two numbers are not comparable: registrants in the old system were not unique, since many taxpayers were registered under several taxes.
  - Adjusting the base for double and triple counting, the GST has increased the number of unique indirect taxpayers by more than 50 percent.
- **Profile of new filers:**
  - Of their total turnover, business-to-consumer (B2C) transactions account for only 17 percent of the total.
  - The bulk of transactions are business-to-business (B2B) and exports, which account for 30-34 percent apiece.
- **Sign of voluntary compliance:**
  - One of the many benefits of the GST was the voluntary compliance it would elicit.
  - A few numbers highlight this phenomenon.
    - There are about 1.7 million registrants who were below the threshold limit (and hence not obliged to register) who nevertheless chose to do so.
    - Out of the total estimated 71 million non-agriculture enterprises, it is estimated that around 13 percent are registered in the GST.
- **Opting out of composition scheme:**
  - Those registered under composition scheme pay a small tax (1 percent, 2 percent or 5 percent) on their turnover and are not eligible for input tax credits. This set up minimizes their administrative burden, but also makes it difficult for them to sell to larger firms, which would not be able to secure input tax credits on such purchases.
  - For this reason, more than 54.3 per cent of those eligible to register under the composition scheme (current threshold for which is fixed at turnover till Rs. 1.5 crore), chose instead to be regular filers.
- **Other facts:**
  - Maharashtra, UP, Tamil Nadu and Gujarat are the states with the greatest number of GST registrants.
  - UP and West Bengal have seen large increases in the number of tax registrants compared to the old tax regime.

TAX BASE AND ITS SPATIAL DISTRIBUTION

- Much of the discussions in the run-up to the GST centered on the size of the tax base, and its implications for the Revenue Neutral Rate (RNR).
- **Size of Tax Base:**
  - The Revenue Neutral Rate (RNR) Committee had estimated a base of Rs. 68.8 lakh crore.
  - The GST Council had estimated a base of Rs. 65.8 lakh crore.
  - Current data suggest that the GST tax base (excluding exports) is Rs. 65-70 lakh crore, broadly similar to these two previous estimates.
- **Revenue Neutral Rate:**
  - Based on the average collections in the first few months, the implied weighted average collection rate (incidence) is about 15.6 percent.

- So, as estimated by the RNR committee, the single tax rate that would preserve revenue neutrality is between 15 to 16 percent.

- **Spatial distribution of tax:**
  - Earlier there was anxiety amongst the manufacturing states that the switch to a destination and consumption-based tax would transfer the tax base toward consuming states.
  - Considering the state-wise share of the total GST base, the top states are
    - Maharashtra (16 percent),
    - Tamil Nadu (10 percent),
    - Karnataka (9 percent),
    - Uttar Pradesh (7 percent), and
    - Gujarat (6 percent).
  - Data shows that each state's share in the GST base is almost perfectly correlated (coefficient of 0.95) with its share in overall GSDP.
  - So the biggest tax bases still seem to be in the biggest producing states manufacturing or overall GDP, including services.
  - It is true that the share of Maharashtra's and Gujarat's tax base under the GST is lower than their share of manufacturing. But because these two states also have a significant presence in services, their tax base share remains in line with their share of GSDP.
  - Overall, the data seem to suggest fairness and balance in the GST outcomes

SIZE DISTRIBUTION OF INTER-FIRM TRANSACTIONS

- Knowing the nature of transactions between firms is critical to formulating policy, especially designing compliance procedures.
- All firms are placed in five categories based on their annual turnover:
  - below-threshold, less than Rs. 20 lakhs;
  - below-composition limit, Rs. 20-100 lakhs (the current upper limit of the composition scheme is Rs. 150 lakhs);
  - small and micro enterprises (SMEs), Rs. 1-5 crore;
  - medium, Rs. 5-100 crore; and
  - large firms above Rs. 100 crore.
- **The distribution of turnover is very skewed:**
  - The registered below-threshold firms account for 32 percent of total firms but less than 1 percent of total turnover.
  - The large firm account for less than 1 percent of firms but 66 percent of turnover, and 54 percent of total tax liability.
- **B2C and B2B:**
  - Registered smaller firms (the first three categories) seem to be equally involved in selling to consumers (B2C) and selling to other firms (B2B).
  - Medium and large firms, in contrast, have a much greater presence in B2B than B2C transactions.
- **Why smaller firms choose for regular registration?**

- Before the GST was introduced, it was expected that small dealers who sell directly to consumers would chose the composition scheme while those who sell to bigger companies would opt (or be forced) into regular registration, because purchasing firms would not buy unless they could get input tax credits.
- It turns out that about half the transactions of the below-threshold firms which nonetheless voluntarily chose to comply are actually in the B2C space.
- This suggests that there are other motivations for participation, beyond simply being a supplier to larger companies:
    - Small B2C firms want to be part of the GST because they buy from large enterprises.
    - In fact, 68 percent of their purchases are from medium or large registered enterprises, giving them a powerful incentive to register, so they could secure input tax credits on these purchases.

INTERNATIONAL TRADE, INTERSTATE TRADE AND ECONOMIC PROSPERITY

- Information from new GST data:
    - Last year's Survey provided the first estimates of inter-state trade data in India based on tax data. Those estimates had to be backed out from payments of inter-state taxes (CST) under the pre-GST regime.
    - This year GST returns provide direct data on inter-state trade and its many related dimensions.
    - For the first time in India's history it is possible to know the statewise distribution of international exports of goods and services.
        - Five states—Maharashtra, Gujarat, Karnataka, Tamil Nadu, and Telangana—in that order account for 70% of India's exports.
- **Correlation between prosperity and export performances:**
    - Since these data are available for the first time, one can immediately answer the question of whether prosperity is related to export performance.
    - From graph of GSDP per capita and Export share in GSDP, it can be inferred that: a state's GSDP per capita is highly correlated with its export share in GSDP.
    - The one major outlier is Kerala, but only because it is a large recipient of remittances. If remittances are added and created a broader globalization index for states, Kerala may not be an outlier.
- **Inter-state trade:**
    - Last year Survey had estimated that India's inter-state trade in goods was between 30 and 50 percent of GDP, a relatively high number compared to other countries.
    - GST data suggests that India's internal trade in goods and services (excludes non-GST goods and services) is actually even higher: about 60 percent of GDP.
    - Data on inter-state trade:
        - **The five largest exporting states:**
            - Maharashtra,
            - Gujarat,
            - Haryana,

        - Tamil Nadu and
        - Karnataka;
    - **The five largest importing states:**
        - Maharashtra,
        - Tamil Nadu,
        - Uttar Pradesh,
        - Karnataka and
        - Gujarat;
    - **The states with the largest internal trade surpluses:**
        - Gujarat,
        - Haryana,
        - Maharashtra,
        - Odisha and
        - Tamil Nadu.
    - **Other facts:**
        - The states that export the most also the ones that import the most.
        - The states that trade the most the ones that are the most competitive and run the largest trade surpluses.
  - **One can also ask whether internal trade is related to prosperity?**
    - The correlation of per capita GSDP with international exports is stronger than with inter-state trade.

TRADING SUPERSTARS: INDIAN EXPORT EGALITARIAN EXCEPTIONALISM

- There is a growing literature that documents the emergence of
- Exports superstars means firms that account for a disproportionately large share of exports.
  - For example, in a sample of 32 countries, the top 1 percent of exporting firms account for over 50 percent of exports.
- **Advantage for having export superstar:**
  - It is argued that having and fostering bigness influences the sectoral composition of exports and also helps create comparative advantage and improve long-term prospects.
  - This is in contrast to the more conventional, Schumacherian view that argues for the virtues of smallness, especially small and medium enterprises.
- **New findings from GST data:**
  - Until now, no such analysis has been possible for India because firm level export data are difficult to construct. However, with the new GST data it is possible to construct firm-level exports.
  - Export concentration by firms is much lower in India than in the US, Germany, Brazil, or Mexico. For example:
    - the top 1 percent of firms accounted for 55 percent of exports in Brazil, Germany, Mexico, and USA respectively but only 38 percent in the case of India;

        - the top 5 percent accounted for 91, 86, 91, and 74 percent in those countries, compared with 59 percent in India;
        - the top 25 percent of firms accounted for 99, 98, 99, and 93 percent in those countries, as opposed to 82 percent in India.
    - **Reasons:**
        - Unlike in other countries, Indian data includes exports of services, where concentration ratios tend to be much lower than in manufacturing.
    - **Implications:**
        - The implications of such an "egalitarian" Indian export structure are unclear.
        - The evidence argues in favor of superstars, because they are dynamic and their expansion can have spillover effects on other firms.
        - But concentration can have disadvantages, including impeding competition.

INFORMALITY OF THE INDIAN ECONOMY

- GST data throw up new data that allows a better re-examination of the extent of formality/informality in the Indian economy.
- **Two definitions of formality:**
    - **In terms of social security provided to employees by the firm:**
        - In India:
            - Government provides this for its employees,
            - Employees' Provident Fund Organization (EPFO) provides it to private sector employees in respect of pensions and provident funds; and
            - Employees' State Insurance Corporation (ESIC) in respect of medical benefits.
        - EPFO:
            - The EPFO contribution is mandatory for industries employing greater than 20 workers, and whose monthly wage/salary is below Rs. 15,000. Above that level, contributions are voluntary.
            - Of the total active members (for whom the monthly contribution is deposited by the employer), 86 percent earn less than Rs 15,000, and about 98 percent have opted for a combination of the 'provident fund-pension' option.
        - ESIC:
            - The ESIC contribution is mandatory for certain firms, employing greater than 10 workers, and for workers in these firms whose monthly wage/ salary is below Rs. 21,000.
    - **In terms of firms being part of the tax net:**
        - A second definition of formality is when firms are part of the tax net.
        - Since new data on the GST is available, one can define tax formality as firms having registered under the GST.
        - Based on these definitions, the magnitude of formal sector firms, turnover, tax liabilities, tax paid, exports, and payroll can be estimated.

        - Table 7 below shows a 2x2 matrix for all these variables for different combinations of social security and GST formality. In this table the NSSO's 73rd Survey Round is used to fill in the cell where a firm is neither part of the tax or social security net and annual turnover is less than GST threshold of 20 lakh. This is the pure informality cell in the sense that firms in them are outside the tax and social security net.
- **Key findings:**
    - **Firms both in tax and social security net (Hard core formal sector):**
        - 0.6 percent of firms, accounting for 38 percent of total turnover, 87 percent of exports, and 63 percent of GST liability are what might be called in the "hard core" formal sector in the sense of being both in the tax and social security net.
    - **Firms outside both tax and social security net (Purely informal sector):**
        - 87 percent of firms, representing 21 percent of total turnover, are purely informal, outside both the tax and social security nets.
    - **Firms in tax net but outside social security net:**
        - 12 percent of firms, accounting for 41 percent of turnover, 13 percent of exports, and 37 percent of tax liabilities are in the tax net but not the social security net.
        - These firms are relatively smaller than those in both nets, since they have a lower average turnover and average tax rate, 7 percent compared with 16.3 percent.
    - **Firms in social security net but outside tax net:**
        - Less than 0.1 percent of firms accounting for about 14 percent of turnover are in the social security net but not in the GST net.
        - These are mostly firms that are in GST-exempted sectors (such as education, health, electricity), although there are many firms that appear to be outside the GST even though they are in the GST-included sectors. One possible reason is that they fall below the GST threshold, but there might be others.

Non-Farm Payroll

- Turn next to formal and informal nonfarm payroll.
- **Formal non-farm payroll from social security perspective:**
    - Formal non-farm payroll from a social security perspective is estimated at about 7.5 crores, or 31 percent of the non-agricultural workforce.
    - This estimate includes government non-farm payroll (center and states), which is roughly estimated at 1.5 crore (excluding defence personnel).
- **Formal non-form payroll from tax perspective:**
    - The tax-based numbers exclude government employees and also non-farm payroll that takes place in sectors currently outside the GST such as health and education.
    - Taking all these into account, and adding back government employment, the formal nonfarm payroll from a tax definition is estimated at 127 million.

  - This implies that nearly 53 percent of the non-agricultural workforce (240 million) is in the formal sector.
- These estimates are enterprise-based not household based definitions of employment and also exclude the agricultural sector.
- **Conclusion:**
  - These estimates for formal non-farm payroll, ranging from 31 percent in the case of social security-defined formality and 53 percent in the case of tax-defined formality, are considerably greater than current beliefs about the size of formal sector non-farm payroll.

Note:

There are many different definitions of formality/informality. The most common ones are:

1. whether a worker has a formal contract;
2. whether a worker is a regular/salaried worker (as opposed to self-employed or casual);
3. whether a firm is registered with any branch of the government;
4. whether the firm pays taxes; and
5. whether a worker receives social security.