REVENUE IMPLICATIONS AND ECONOMIC IMPACT

8.1 Computation of Likely Revenue Impact : The Approach

Proposals for tax reform, even when designed on rational principles, are often put aside because of apprehensions of negative implications for revenue. Revenue neutrality thus forms a critical parameter to be kept in view while formulating any scheme of tax reform. It should, however, be stressed that while revenue effects must be given careful consideration, reforms of an injurious tax structure to remove its basic deficiencies should not be held up for revenue reasons alone unless the impact is likely to be severe and the chances of the loss being made up through other measures such as capping expenditures or using alternative revenue sources or cost recovery seem remote.

Keeping in view the understandable concerns about revenue, exercises were carried out to see what would be the revenue implications of the reforms proposed in this study and to derive an idea of their likely impact on the budget of the Centre and the States. The aim was to derive the rate of tax or set of tax rates within the recommended framework which would be revenue neutral. It should be added that because of data limitations the results derived should be taken only as indicative of the likely order of the revenue gain or loss and not definitive estimates of the budgetary impact. As will be seen, since not all the information required for such estimates is available, the calculations had to proceed unavoidably on the basis of certain assumptions which, though plausible, have a vital bearing on the final figures. However, every attempt has been made to check that the assumptions are plausible and not wide of the mark.

In estimating the revenue impact of a consumption tax, the most straightforward way is to apply the recommended rates of tax to the consumption base after making necessary adjustments for the components which would be outside the tax base either because of "home-grown" consumption or exemption of commodities like cereals or by virtue of the threshold for small dealers. An alternative approach is to base the computations on the figures of turnover available with the sales tax administrations and work out the positive and negative impact of each major component of the reform package itemwise. The former may be called the consumption expenditure approach and the latter, the tax turnover route. In the exercises undertaken for this study, both the methods were used. Once the base is estimated, revenue neutral rates can be derived simply by dividing the revenue from the present taxes by the base. Sensitivity analysis was also carried out to see what would be the impact of alternative assumptions. The reference year for the exercises was 1992-93 (except for one State).

8.2 Revenue Neutral Rates for a Uniform VAT at the Centre and the States

8.2.1 Estimates by consumption expenditure method

Computations made by the expenditure method suggest that in the unlikely event of a consumption type VAT being imposed by the Centre uniformly on all goods without any exemption except for an initial threshold and primary agricultural commodities, the rate of tax that would secure the same amount of revenue as Central excises and countervailing duties on imports would have to be about 9 per cent. This assumes that in addition to VAT the Centre would also levy special excise duties on selected items of sumptuary items and luxury consumption and petroleum products. Revenue neutral rate for a uniform State VAT across the country to replace the sales taxes (including motor spirit taxes and the Central sales tax) works out to about 8 per cent. If services were included, the revenue neutral rates of Central VAT would be a little over 8 per cent and of the State VATs, a little less than 8 per cent. Table 8.1 sets out the estimates for alternative assumptions regarding thresholds and separately for bases comprising goods only and goods and services. It should be noted that these computations proceed by assuming that the

Table 8.1

Revenue Neutral Rates of a Uniform VAT for India: An Illustration for 1992-93

(Per cent)

Taxes to be replaced	Revenue neutral VAT rates with VAT threshold@ at	
	Rs.30 lakh	Rs.5 lakh
A: Taxation of goods only		
I. Central VAT: Central excise and Countervailing duty on imports	9.3	9.0
II. State VAT: Sales tax, CST Motor spirit tax and Addl.Excise Duty in lieu of Sales Tax	8.6	8.3
B: Taxation of goods and services		
I. Central VAT: Central excise and Countervailing duty on imports	8.4	8.1
II. State VAT: Sales tax, CST Motor spirit tax and Addl.Excise Duty in lieu of Sales Tax	7.8	7.5

Source: Relevant Budget Documents.
Note : @ VAT threshold limits relate to annual turnover.

tax bases would be truly comprehensive and there is no leakage on account of evasion or base erosion through concessions, incentives, etc.

8.2.2 By Tax Turnover method

The revenue impact of the suggested reforms on the excise side and the underlying assumptions are set out in some detail in Appendix A1. Attention is confined in this sub-section to the likely revenue implications of the replacement of State sales taxes by VATs to be levied by the States under the scheme outlined in Chapter 7. As it was not possible within the time available to do the exercises for all States, estimates were derived for five, viz., Andhra Pradesh, Gujarat, Maharashtra, Rajasthan and Tamil Nadu. Similar exercises can be carried out for other States depending on the availability of data.

The starting point for applying this approach is the figure of taxable turnover. Basically, the attempt was to estimate first, the base of the tax from the assessed (or reported) figure of turnover for a year after allowing for the rebate on inputs and capital goods for which credit would be allowable under a VAT regime. This essentially involved estimating (i) the total value of goods that go out of the State at present whether in the course of inter-State sale or otherwise as consignment, etc., and (ii) the value of inputs which would be eligible for tax credit in the computation of the VAT payable on the final products. In the absence of data on the inter-State movement of goods, use was made of the data furnished by the Sales Tax Department, Maharashtra, regarding (a) the proportion of goods produced in the State that go out in the form of consignments to those sold inter-State, and (b) the proportion of local inputs in the total inputs used. These data were based on information relating to 142 large dealers. Some adjustments were made in the ratios derived from these data in the light of discussions with officials of sales tax departments of other States. Conservative assumptions were also made for the likely gain to revenue from the widening of the base with the withdrawal of exemptions and tax concessions, and from improvement in administration. Results so derived for the five States for alternative bands of tax rates are given in Table 8.2.

Table 8.2 shows that with the three-rate structure of between 4-5 per cent for essential commodities, a standard rate of 12-14 per cent, and rates ranging from 20 to 32 per cent for the special or sumptuary items would be revenue neutral for all the five States. For some States (Andhra Pradesh and Rajasthan), the standard rate would have to be no more than 8 or 9 per cent to ensure revenue neutrality. This implies that standard rates of 12-14 per cent would produce for the two States revenue substantially larger than what they are getting at present from their sales taxes. It is only in the case of Gujarat that standard rate would have to be in the range of 14 per cent and about 32 per cent for the

special category items to achieve revenue neutrality. If a revenue gain of 10 per cent is allowed for with better administration, the standard rate may go down by about one percentage point.

Table 8.2

Revenue Neutral VAT Rates for Selected States : 1992-93

State	With no administrative improvement		With administrative improvement*	
	Tax rate regime	Average rate	Tax rate regime	Average rate
Andhra Pradesh	(4,9,20)	10.3	(4,8,20)	9.5
Gujarat	(5,14,32)	13.0	(5,13,26)	12.0
Maharashtra	(4,11,23)	11.7	(4,10,22)	10.7
Rajasthan	(4,8,20)	10.7	(4,7,20)	10.0
Tamil Nadu	(4,14,20)	13.1	(4,12,22)	12.1

Notes: 1. Figures in brackets give VAT rates for low rated, standard rated and high rated goods, respectively.
2. Figures for Gujarat relate to 1991-92.
3. These computations are based on tax turnover data furnished by the State Sales Tax Administrations.
4. * Assuming a resulting increase of 10 per cent in the tax yield.

It is seen, on certain plausible assumptions, the revenue-neutral average rates derived by the consumption expenditure method are in line with those obtained through the tax turnover approach. The average revenue neutral rate for fifteen major States based on the consumption expenditure method are set out in Table 8.3. Broadly, it would appear that the average rate would be high in States where the level of taxation is currently high. In States where the level is relatively low at present there will be large accretion of revenue if the harmonized rates are applied. Details of the methodology, assumptions and data base are described briefly in Appendix 2.

It should be stressed again that these estimates are based on available data and plausible assumptions. The assumptions are on the conservative side. For instance, it has been assumed that there will be only 10 per cent increase in the tax base from withdrawal of exemptions and tax concessions even in States where the exemptions are extensive (e.g., Maharashtra and Gujarat). Gain assumed from achievable improvement of administration, viz., 10 per cent is also on the conservative side. Further, no account has been taken in these computations of the likely accrual to the States' revenues from taxation of services which, like the works contracts, may come within their purview. Of course, these computations do not allow for the revenue impact from zero-rating of international exports. Roughly, it appears that revenue loss on this account may be of the order of Rs 1,000 crore for the country as a whole. At the same time, it was not possible to estimate the likely gain to revenue from the disallowance of input rebate in respect of items bearing high rate of tax like petrol and diesel. Taking all this into account, one would feel that the estimates are robust and not unrealistic. However, if the reforms are to gain acceptance by all States, there has to be an assurance that large

Table 8.3

Revenue Neutral VAT Rates for Major States in India by Consumption Expenditure Method for 1992-93

(with threshold for VAT registration at Rs.5 lakh p.a.)

State	Revenue neutral VAT rates (%)
Andhra Pradesh	8.1
Gujarat@	11.0
Maharashtra	10.6
Rajasthan	6.3
Tamil Nadu	11.0
Assam	8.5
Bihar	6.3
Haryana	7.8
Karnataka	12.7
Kerala	7.1
Madhya Pradesh	6.2
Orissa	7.8
Punjab	5.8
Uttar Pradesh	5.6
West Bengal	7.4
15 States	8.3

Note: @ Figures for Gujarat relate to 1991-92.

revenue loss to any State will be met, at least for an initial period, out of grants from the Centre. We believe such an occasion will not arise, if serious effort is made to overhaul the administration.

It might be relevant to note in this context that in almost all countries where VAT has been introduced on a comprehensive base, the additional revenue accrual has almost invariably outstripped the estimates. In fact, VAT is opposed by many in the USA on the ground that it constitutes a "money machine" and would enable the government to spend recklessly.

In short, if properly implemented as a package, there should be no apprehension of revenue loss either for the Centre or for the States. On the contrary, the exchequer will gain and/or the rates may be brought down to yield the same revenue as is yielded by the present system.

8.3 Likely Impact on the Economy

This section reviews the potential impact of consumption tax reform on the economy. The analysis is based on the assumption that the reform measures are revenue neutral, i.e., that the tax rates under the new system are set so as to yield the same revenues as under the current system. The issues discussed are the impact of the reforms on prices, distribution of tax burden, and the level of potential output in the economy.

Replacement of the flawed and archaic Central and State sales taxes by a comprehensive VAT (accompanied by suitable measures to streamline the tax administration) would be the single most important tax initiative in India since Independence. It would affect virtually all sectors of the economy and could lead to major adjustments in prices and factor costs. The simpler and rational structure of VAT would reduce distortions in production and consumption decisions, lower the cost of investment and production, and enhance the competitive position of domestic industries in international markets. The overall result would be an increase in India's potential output.

While there can be little doubt about the overall beneficial impact of reform on the economy, the extremely complex and irrational structure of the current system and the paucity of data on its operation render quantification of the impact an extremely difficult task. The discussion below is thus necessarily qualitative in nature. It describes the direction of influence of the principal reform elements, without attempting to quantify the magnitudes.

8.3.1 Effect on prices

The introduction of VAT could have an impact on the overall price level and would cause shifts in relative prices. While a revenue-neutral replacement of the current taxes by VAT may or may not have any impact on the overall price level, relative price adjustments are a pre-condition for the beneficial effects of tax reform to occur. In a market economy, the influence of the tax system is felt mainly through its impact on the prices of inputs and outputs. It is through the distortions caused in the relative prices of goods and services that the current tax system has a detrimental impact on production and consumption decisions in the economy. The reform measures would lead to more output in the economy only to the extent that they are successful in reducing or eliminating such distortions.

The nature and magnitude of price changes would depend upon a variety of factors, including the following:

- the aggregate revenue yield of the old and the new systems;
- the rate of expansion in money supply;
- the statutory tax rates under the old and the new systems;
- the degree of competition in the various sectors of the economy, and the pattern of backward and forward shifting of the tax; and
- the mark-up pricing policies of wholesalers and retailers.

In what follows, we discuss the influence of these factors on absolute and relative price changes.

8.3.1.1 Overall price level

Sales tax reforms are invariably accompanied by intense political debates about their impact on the overall price level. Those opposed to reform assert that it would lead to price increases which would have an adverse impact on the purchasing power of workers in the unorganised sector and those on fixed incomes. Advocates of reform downplay such fears. While such debates are healthy and necessary for proper consideration of the potential adverse effects of reform, international experience suggests that a revenue-neutral replacement of sales taxes by VAT is not inflationary. It may lead to a one-time increase in the overall price index if the reform is not revenue neutral, but it does not by itself set in motion inflationary forces in the economy. Even the one-time price adjustment depends crucially upon monetary policy. The overall price level can go up only if there is an accommodating increase in money supply.

Tait examined the experience of 35 countries (including both developed and developing economies) with sales tax reforms, and found that in 22 of the countries the introduction of VAT had little or no effect on the consumer price index.[33] In seven countries, there was a one-time shift in the price index. Five countries experienced an acceleration in the rate of inflation, and one country experienced both a one-time price increase and an acceleration in the rate of price increase. His examination of changes in the rates of existing VATs also did not suggest any automatic link between VAT rate changes and inflation.

There are no unique features of the Indian tax system or the economy that could cause its experience to differ significantly from that of other countries. Assuming no change in aggregate revenues and the monetary policy stance, the impact of VAT on the overall consumer price index should be limited to a one-time adjustment, the magnitude of which could be influenced by the following two opposing forces.

First, under a percentage mark-up pricing policy of wholesalers and retailers, a tax at the first point of sale results in a much larger increase in the final price to consumers than the tax actually collected by the government. To recall how the present system of sales taxation causes cascading, assume that a product sold by a manufacturer for Rs 100 gets marked-up by 20 per cent, to Rs 120, by the wholesaler, and by 30 per cent, to Rs.156, by the retailer. With a first-point tax of 10 per cent on the manufacturer's selling price, the retail price of the product would be marked-up to Rs 171.6 (=110x1.2x1.3), or Rs 5.6 more than the amount of tax collected by the government from the manufacturer. Under a VAT, the retail price increase would be exactly equal to the tax collected by the government. Assuming no change in mark-up percentages, the introduction of VAT could, in such circumstances, lead to a one-time decrease in retail prices.[34]

Second, it is possible that a part of the tax, that falls on production and distribution of inputs, is not being shifted forward to consumers, but is being borne by business owners in the form of reduced profits. Elimination of tax cascading under the new system could, in that case, simply lead to an enhancement of profits and the tax savings to businesses may not be passed on to their customers. The introduction of VAT would, in effect, result in a replacement of the currently non-rebatable input taxes by the tax on final consumer sales. In the absence of full forward shifting of the tax savings from the rebating of input taxes, the reform could have the opposite effect of leading to a one-time increase in the consumer price index.

33. See Tait (1991).

34. It may be argued that in the real world this effect would be weak because it assumes a non-competitive market. However, in the absence of competition, one should not expect any pyramiding or price increase by more than the amount of the tax, since given any scope for pyramiding, dealers would raise the prices to what the market can bear, tax or no tax. What could cause a downward shift in prices even in the absence of pyramiding is the removal of the tax on tax (and associated interest burden) that unrebated multi-stage taxation gives rise to but is eliminated with VAT.

Overall, the magnitude of the influences noted above is not expected to be significant. It would be unrealistic to assume that the percentage mark-ups would remain unch anged under the new system. Wholesalers and retailers could not be expected to accept a reduction in their profits implied by the constant mark-up assumption. It is likely that they would revise their mark-ups to achieve the target profit amount. By the same token, competitive forces would prevent producers and distributors from keeping all of the windfall gain from the elimination of tax cascading. In fact, with the liberalisation of domestic industrial and international trade policy regime, domestic producers will be facing increasing competitive pressures (in both domestic and foreign markets) and would not be able to keep the tax savings from input tax rebates. Foreign suppliers do not incur Indian taxes on their inputs. Their prices would incorporate only those taxes that apply to the importation or local sale of finished products.

8.3.1.2 Relative price changes

The relative price changes occur primarily because of changes in the effective rates of tax (defined to be the total tax burden on a commodity divided by its pre-tax retail price) under the old and the new systems. The effective rates under a VAT extending to the retail level would equal the statutory rates. However, under the current system there is little congruence between the effective and the statutory rates. The two diverge because of a variety of factors.

First, where the tax is imposed at the first point of sale, the effective rate of tax would be lower than the statutory rate because of the exclusion from the tax base of the subsequent value-addition by wholesalers and retailers. Second, to the extent the burden of non-rebatable input taxes is shifted forward to consumers, the effective tax rate on a product would be higher than the statutory rate applicable to the sale of the finished product alone. Third, because of the application of the CST on inter-State sales, the effective rate on products imported from other States would be higher than the statutory rate applicable to local sales. Fourth, given the extent of tax evasion under the current system, the statutory rates may apply to only a small fraction of total consumption of a given product. The benefit of tax evasion could accrue to the vendor in the form of higher profit, to the consumer making a particular purchase without paying the tax, to all of the consumers of a given product, or to both the vendor and the consumers. Where consumers receive at least a part of the benefit, the effective tax rate would be lower than the statutory rate though the benefit flowing from such divergence would accrue arbitrarily across producers and consumers.

One other general observation that can be made is that under the new system tax collections from luxury consumer items like TVs, refrigerators, cosmetics, automobiles, and VCRs could go up relative to other products. Such products are subject to relatively larger non-taxable value-addition subsequent to the first point of sale. They have also benefited from a substantial drop in the statutory rates, to the level of basic necessities, because of inter-State competition. The new system would eliminate both of these advantages and cause the relative tax burden on such products to increase. This would also be the case for products and services that become taxable for the first time and that do not require a large input of taxable goods (e.g., labour component of works contracts).

It may be of interest to note here that with the introduction of the VAT principle in Kerala sales tax for selected durable consumer goods referred to earlier, retail prices have already come down while revenue has gone up even though the rates of tax have been reduced. The fall in prices per unit has been more than the reduction in the tax incidence.

8.3.2 Distribution of tax burden

Consumption taxes, regardless of the form in which they are levied, are generally regressive. In the past, governments have attempted to ameliorate the regressivity through exemptions and lower rates of tax for basic necessities that account for a larger proportion of the total consumer basket in the lower-income brackets. As mentioned in the earlier chapters, there is now a growing

realization in the industrialized countries that such measures do not lead to a tangible reduction in the overall regressivity of tax, but lead to excessive complexity in the design. Consumption patterns in industrialized countries are such that the rich benefits as much from the exemptions and lower rates as the poor. The burden on lower-income households could be reduced more effectively through an adjustment in their social welfare benefits or a supplementary social transfer payment.

This prescription of a single uniform rate for all consumer goods and services may not be readily acceptable in India, for both economic and social reasons. There are significant differences in the consumption patterns of lower- and upper-income households in India. The basic necessities account for virtually all of the consumer basket in the lower-income brackets. Application of tax to necessities at the full standard rate would impose undue burden on households in these brackets. Moreover, given the absence of any comprehensive system of social transfer payments, there would be no alternate mechanism for offsetting this burden. It is for this reason that the proposed rate structure continues either an exemption or a lower rate for basic necessities.

An assessment of the overall distribution of tax under the old and the new systems requires data not only about the relative price shifts, but also the distribution of consumer expenditures by income bracket. Unfortunately, neither of these data is available in sufficient detail to allow a proper assessment. The difficulties in estimating relative price shifts were noted above. There are no data available on consumer expenditures by income bracket. The only data available is by the size of total consumer expenditures, for the year 1987-88. These data are of limited usefulness because they do not disaggregate households with expenditures in excess of Rs 700 per month. Given this limitation, one can only make some general observations about the likely impact of the proposed tax reform measures.

First, the continuation of the exemption or the lower tax rate for basic necessities should minimize any overall increase in the tax burden on lower-income households. Even where certain necessities become taxable for the first time, it may not necessarily represent a net tax increase. It may represent only a partial substitute for the input taxes or the CST currently collected in the producing States.

Second, the expected increase in the relative tax burden on luxuries, through the elimination of inter-State competition and inclusion of wholesale and retail value-addition in the tax base, should serve to shift the distribution of tax burden toward upper incomes.

Third, the reduction in the number of rates should not have any adverse impact on the overall distribution of tax. There is no rational basis for the current multiplicity of tax rates and it is doubtful that it is designed to serve any well defined income distribution objectives. Even if it were, few would dispute the fact that the administration is incapable of handling such diversity of rates and that it is highly unlikely that the system is producing the intended results.

Lastly, the elimination of the CST and the zero-rating of inter-State sales should enhance the revenue potential of the lower-income consuming States. This enhancement could be viewed as a form of revenue transfer from the upper-income producing States. While its benefits would accrue to all residents of the consuming States, it should lower the overall regressivity of tax, given the preponderance of lower-income households in such States.

8.3.3 Impact on potential output

One of the most significant advantages of VAT is that it can be designed so as to interfere as little as possible with the market decisions of consumers, producers, workers, and investors. It is this neutrality feature that makes VAT conducive to economic efficiency and higher potential output and that is responsible for its rapid expansion around the world. The expected economic efficiency gains are a compelling reason for the introduction of VAT in India as well. The present sales and excise taxes in India are a

serious impediment to economic growth. Their replacement by a neutral and rational VAT could yield substantial dividends to the Indian economy in the form of larger output and faster economic growth.

The following are the principal channels through which the proposed reform measures would benefit the Indian economy.

8.3.3.1 Reduced misallocation of resources

The VAT would reduce or eliminate the distortions in the consumer and producer decisions caused by the highly flawed structure of the current taxes, characterized by multiple rates, exemptions, selective incentives and tax cascading. As noted earlier, the current system is so complex and arbitrary that it is not even possible to calculate the effective tax rates on various products, let alone any quantification of their adverse economic effects. Even in the absence of any data, it would not be unreasonable to assert that there are no two products or firms in the economy that bear exactly the same effective tax burden. Such extreme variations in effective tax rates could be inflicting a substantial loss on the economy.[35]

The current system distorts both production and consumption decisions. The production decisions are distorted mainly through the lack of full rebating of input taxes and the resulting distortions in relative factor prices. Producers are prevented from the use of the most efficient techniques of production. They also organize their businesses so as to minimize their purchases of taxable inputs from third parties, e.g., through vertical integration of production of inputs and finished output. The multiplicity of effective tax rates is the main source of distortions in consumer decisions. As noted earlier, the effective tax rates vary not only because of the variation in the statutory rates, but also because of tax cascading, lack of uniformity in tax compliance and enforcement, and the imposition of tax at the manufacturing or the first point of sale.

The reform measures should lead to a greater uniformity in effective tax rates, and reduce the extent of tax cascading. In turn, they would contribute to improved resource allocation, increased competition, higher factor productivity and larger national output. With the reduction in input costs, Indian exports would become more competitive in the world markets.

8.3.3.2 Lower cost of capital and higher investment

The reform measures would result in a lowering of the cost of capital through full rebating of sales and excise taxes on production machinery and equipment. Replacement of the State sales taxes by a VAT extending to the retail level would result in an additional capital cost saving in the form of reduced financing costs for inventory of goods for resale. Under the first-point tax, the inventory of wholesalers and retailers includes the tax already collected by the manufacturer. This results in additional financing costs to them. Under a VAT, wholesalers and retailers enjoy a net cash flow advantage to the extent their tax collections on sales exceed the tax paid on their purchases. This cash flow advantage, which continues until the tax is remitted to the government, serves to lower the overall costs of capital for the registered firms.

Lower capital costs should lead to higher potential output by inducing more investment and encouraging modernization of plant and equipment.

8.3.3.3 Free inter-State flow of goods and services

The CST and tax incentives for location of industry in selected areas result in unhealthy inter-State tax competition and distort the location of business activity in the Indian common market. The reform measures

35. Canada estimated the variations in effective tax rates under its flawed manufacturer's sales tax to cause a loss of as much as 1 per cent of its national output. The flaws of the Indian system are much more serious and would translate into a much bigger loss. Studies carried out for the European Community showed that absence of a harmonized system of commodity taxes probably entailed a loss of output growth by as much as 5 per cent per annum ("Cost of Non-Europe" as it was described).

would result in a virtual elimination of such distortions. The inter-State competition would be eliminated through harmonization of State VAT rates, and embargo on the use of tax incentives for the location of industries in particular regions. The destination principle of VAT would ensure that the final tax burden on a product would no longer be dependent on the location of its production. The tax cascading that occurs through the application of the CST in the producing States would be eliminated with the zero-rating of inter-State sales. The resources that are currently devoted by business firms to contrive a variety of tax planning maneuvers to overcome the tax barriers would be freed up for more productive uses.

In addition to the above, the economy would also benefit from the simplification of the tax system and greater uniformity in its enforcement and compliance. Simpler laws should lead to a reduction in the harassment of the business community. The frequent disputes under the current system impose very substantial deadweight losses on the economy in the form of litigation costs as well as increased uncertainty in business planning.

8.3.3.4 Sectoral and regional benefits

The current system is a source of frustration to businesses throughout the economy, regardless of the sector or region to which they belong. As a result, the benefits of increased output and simpler tax system are expected to be widespread, accruing to all sectors and regions. The level playing field would ensure greater fairness in the application of tax laws and fewer competitive distortions. The resource sectors, such as mining and forestry, would benefit substantially from the reforms because they would be able to claim a full rebate for the tax on their production inputs and any tax collected by them would, in turn, be fully rebatable to manufacturers who buy their output for further processing. Manufacturers of machinery and equipment would likewise benefit from the removal of cascading under the VAT system. The reduced cost of capital would lead to more demand for their output. The wholesale and retail sectors would face reduced harassment and enjoy an enhancement in their cash flow.

The consuming States would benefit from the removal of the CST in the producing States on inter-State sales. The producing States would, in turn, benefit from the removal of hidden taxes on inputs to their production activities. The greater transparency of tax would allow consumers to better inform themselves of the total tax burden on a given product and thereby exercise pressure on the governments in following a more disciplined approach in their expenditures. The new system would provide a more stable revenue source to the governments that is easier to administer.