Economy This Week (24th Aug to 30th Aug 2020)

TABLE OF CONTENTS

1. India does need a fiscal council (TH 25/8/20)

- The fiscal situation was bad and the pandemic has made it much worse. As per CAG, the Fiscal Deficit (FD) was 4.6% for FY20 (0.8% higher than the revised estimate). For the current fiscal the deficit is expected to be around 7% against a budgeted 3.5%, due to a sharp decline in revenues. The general fiscal deficit could go up to 12% and debt up to 85%. If the off-budget liabilities are considered then the situation is much more alarming.
- The current situation requires the government to be spending more but once the pandemic is over, there is a need to get back to controlling the deficit.
- In addition to the questions about large deficits, there are questions raised over transparency. The report of the CAG has flagged various issues related to finances of the government such as off-budget financing, rolling over of subsidies, methods of disinvestment, etc.
- To make the system more accountable and transparent, the 13th Finance Commission recommended that the Finance Ministry appoint a committee that would later convert into a Fiscal Council, which would be involved in the fiscal impact of policy decisions, independent review of FRBM compliance, etc. The FRBM Review Committee also made a similar recommendation. In order to maintain the independence of the council, the 14th Finance Commission recommended establishing an independent fiscal council, appointed by and reporting to Parliament (by inserting a new section in the FRBM Act).
- The mandate of the fiscal council (FC):
  - Independent FC will promote stable and sustainable public finances
  - Unbiased report helps raise the debate and bring transparency and accountability
  - Evaluation of the impact of various policies on the finances will reduce the populist measures
  - Raise awareness among the public regarding the constraints attached to the budgeting
  - Will raise awareness and level of debate in the Parliament, hence it will work as a conscience keeper
- The Fiscal Council (FC) is an Independent Financial Institution (IFI) and there are about 36 countries with IFIs in 2014 and more have been set up since then. Though most of these are set up in developed countries, more and more developing countries are showing an interest in these institutions.
- OECD has documented 9 principles needed for successful fiscal councils - independence and non-partisanship; mandate; resources; relationship with legislature; access to information; transparency; communication; external evaluation and local ownership.
- Evaluation of IFIs - as per IMF study:
  - Countries tend to have more accurate macroeconomic and budgetary forecasts
  - IFIs are likely to raise public awareness and level of debate on fiscal policy

2. Challenge of catching elusive taxpayers (TH 25/8/20)

- With the pandemic, the expenditure of the government has been rising while the revenues have been falling. The government does not have any other way out except to collect more taxes. With this in mind, the government has recently announced tax reforms. As per the data for 2018-19, only about 1.5 crore people out of a 135 crore population pay income taxes.
- The number of tax filers has increased but the number of taxpayers has decreased. This is because of the hike in the exemption limit and concessions offered. The exemption limit was hiked from ₹ 1.5 to ₹ 2.5 lakh. In addition to this, the government announced that those filing returns on incomes up to ₹ 5 lakh will not have to pay any tax.
- As per data released in 2016, the number of taxpayers in 2012 was around 1.2 Cr. So reforms for the last 6 years have not yielded much results in terms of bringing more people into the taxpayer bracket. The direct tax to GDP ratio, which is stagnating at around 5.5% is another indicator of this. One reason for this is that there is huge tax evasion.
  - As per a 2016 report, the top 10% of the population earned 55% of the national income. If only these people paid the taxes correctly then the income tax to GDP ratio would be a whopping 18%.
  - In addition to this if all the other direct taxes are taken into consideration then the ratio would easily cross 20%.
- The government had implemented demonetisation and a host of measures before and after it to bring people in the tax bracket and counter the menace of black money. The data shows that it's not the case.
- Hence, the government has introduced a new system of faceless assessment, wherein the system would be allocating the assessments to different tax officials and the scope of corruption is tackled.
- Concerns with the new system:
  - There is a concern that software can be manipulated by the people who know the system.
  - The departments are understaffed and the officers have inadequate time to scrutinize the cases.

3. Why the fall in taxpayers isn't worrisome (BL 27/8/20)

- The government has said that there are 1.5 Cr effective taxpayers out of 5.95 Cr who have filed income taxes. The difference in the number is because
  - 75% of these tax filers have a taxable income of less than ₹ 5 lakh and the government has announced that they would be provided with a 100% rebate (25% of the total number of tax filings comes at about 1.5 Cr).
- Assuming a growth rate of 5%, this year the number of filings should be around 6.4 Cr.
- The 1.5 Cr population which pays the taxes account for just 1.1% of the population. If this is compared with the population with voting age (55% of the total population), the ratio would be around 2%. This is very poor compared with other countries such as Sweden, Norway, Canada where this ratio stands at over 80% and in the case of other developed countries, it is around 40%.
- However, India has some peculiar features which need to be considered:
  - 62% of the total population falls in the working-age group of 15 to 59 yrs. This reduces the number of liable taxpayers to 81 Cr.
  - Of this, around 55% are employed in agriculture and allied activities and thus may be paying no taxes. Thus, the tax base is reduced to 37 Cr.
  - Of this, if the people working in the unorganized sector and people having taxable income of up to ₹ 5 lakh is taken out, then the number further reduces to 22 Cr (assuming the total deductible number is around 40%).
  - Of this number, around 6 Cr are filing taxes.
- However, it is true that there is rampant tax evasion which happens at every step. As per the data put out by the Finance Ministry:
  - 92% of those filing returns have an income under ₹ 10 lakh

    - 7% have an income between ₹ 10 to 50 lakh
    - 1% have income over ₹ 50 lakh
- As per an Oxfam report, 73% of the wealth generated in 2017 has gone to the richest 1%.
- Therefore it is the top 1% which earns the highest income and the scrutiny of these tax filings should be done stringently so that the workload on tax officials comes down and the tax collection also increases.
- In addition to this, there are certain high revenue earners who are completely out of the tax bracket. Hence the tax officials need to track large value transactions. There is a need to process the information in an effective way so that it will avoid unnecessary harassment and irrational tax demands.
- The scrutiny of the tax filings of salaried people with income below 10 lakh (where the employer deducts the tax) may be reduced. This could save a lot of time and manpower efforts.

4. Export preparedness Index - EPI 2020 (IE 27/8/20)

- The first-ever EPI was launched by NITI Aayog.
    - All the states and UTs were evaluated on 50 parameters such as export promotion policy, business environment, R&D support, export diversification, infrastructure, etc.
    - Gujarat has topped the list.
- EPI 2020 has flagged the regional disparities in export infrastructure; poor trade support and growth orientation; and research and development infrastructure as key barriers to boosting India's exports.
- As per the report prepared by NITI Aayog in partnership with the Institute for Trade Competitiveness, most of the states have failed to address these issues.
- There is a need for the states to develop forward and backward linkages to global value chains, and increase the diversification of the exports. This would allow the states to export high-value products.
- Short term solutions:
    - Joint development of export infrastructure
    - Collaborating with academic institutions and promoting robust industry, academia and government linkages
    - Promoting state-level engagements for economic diplomacy
    - Emphasised focus on designs and standards

5. Doing business report (BL 29/8/20)

- The World Bank (WB) has decided to pause the publication of the Ease of Doing Business Report (EoDBR) as there have been instances of data irregularity.
- The incidences of data irregularity relate to countries such as China, Saudi Arabia, UAE and Azerbaijan.
- Government officials have stated that this may not have any kind of negative impact on India's ranking, as these countries are ranked higher than India, it may lead to improvement if these countries' rankings are lowered.
- India had ranked 63rd in 2020.

6. What is the new idea of supply chains (TH 30/8/20)

- Japan has mooted the idea of Supply Chain Resilience Initiative as a trilateral approach to trade with India and Australia as the other two partners. India, Japan and Australia are already are a part of another grouping with the US - the Quad.
- Supply chains got disrupted because of the pandemic, trade wars, etc. This led to the disruption of the supply of commodities to the destination countries. Now Japan wants to initiate a strategy wherein the supply sources will be diversified and the dependence on a single supplier will be reduced.
- 24% of imports into Japan were from China and in February these imports fell by half. In addition to this, the trade wars between the US and China have been of concern for Japanese trade circles for some time now. Japan is heavily reliant on both of these countries for imports ranging from intermediary goods, raw materials, iron, etc.
- Why India?
    - Japan is the fourth-largest investor with a cumulative investment touching $33.5 bn between 2000 to 2020 accounting for 7.2% of inflows during this period.
    - Imports from Japan to India have more than doubled in 12 years' duration to $12.8 bn in FY19.
    - Exports from India to Japan stood at $4.9 bn in the same year.
    - There are over 1400 Japanese companies working in India.
- Pros and cons for India:
    - With the tensions rising between India and China, partners such as Japan are sensing that India could be getting ready to hold the dialogue with them. However, India cannot cut ties with China all of a sudden as its dependence on China for various imports is very high (for example, in electronics, China accounts for 45% of India’s imports).