3

The Impacts of Recent Changes in Revenue-raising Practices

Reduction of trade taxes

For the GOI, the most important change in its resource mobilisation practices was the shift in the composition of its tax receipts. As Table 2.2 showed, the weight of taxes on trade has gone down significantly while that of direct taxes has risen fast. From 1990/91 to 2003/04, the share of direct taxes in the GOI's total tax revenue rose from less than 20 per cent to over 40 per cent; at the same time, receipts of customs duties fell from 36 per cent to less than 20 per cent. On the whole, the GOI's tax receipts as a percentage of the country's GDP have been slowly going back to their earlier level of around 10 per cent. In other words, the GOI is now deriving approximately the same percentage of GDP as tax receipts as before but from a different set of taxes.

Reducing trade taxes had become necessary as a part of the new economic policies that promoted a more open trade regime. On the other hand, reforms of the direct tax system sprang from the long-standing recommendations of several expert committees (GOI, 1971, 1991; NIPFP, 1994) for a thorough overhauling of the direct tax regime in the interest of both greater yield and more efficient collection (i.e. with minimum collection costs). The very high and complicated multiple rates and exemptions were affecting incentives to work as well as encouraging avoidance. In the years since 1991, rates of direct taxes have been reduced, rationalised and enforced much more vigorously. Moreover, special efforts have been made to widen the base of personal income tax, which is still very narrow because it leaves out income from agriculture, value added per year from which still accounts for about 20 per cent of the country's GDP.[12] Nor is the system capable of levying and collecting direct taxes from the vast sector of informal workers, i.e. most of those who are self-employed or work for unregistered employers. The tax authorities have nonetheless made special efforts in the last ten years to expand that network by devising different methods of identifying new taxpayers. In order to identify and assess the incomes of those informal sector workers who are relatively affluent, authorities have resorted to other official or semi-official records such as those of persons with a telephone, a motorised vehicle, a credit card or a passport. This has enabled them to substantially step up their collection of direct taxes over the last few years.

Impact of the changes

Changes in income tax rates have little direct impact on the poor because they do not pay income taxes; in the year 2005/06 the tax was applicable to persons with incomes equal to or more than Rs. 100,000 per year net of personal allowances and exemptions for savings, housing, etc.[13] The majority of Indian citizens do not earn more than a fraction of that sum even if they get work throughout the year All in all, only about 16 million workers in India, out of the approximate total of 370 million, were identified as liable to these taxes in the year 2002/03 (GOI, Economic Survey, 2003).

For the few women who are assessed for personal taxes, the regulations are exceptionally generous in India. Even in the case of married couples, husband and wife are assessed separately and each independently gets a personal allowance as well as all applicable exemptions.[14] In addition, while the personal allowance limit for a man in 2004/05 was Rs. 100,000 per annum, for women it was Rs. 135,000, based on the argument that a working woman needs to get paid help at home. Again, these apply to a very small group of relatively rich women and are of little relevance to more than 99 per cent of working women in the country.

Theoretically, a reduction in any tax or duty on trade or consumption increases the welfare of consumers by reducing not only prices but also distortions (introduced by taxes) in the relative market prices of taxed and non-taxed items. Trade liberalisation also adds to the choices available to consumers. On all these grounds the new trade tax policies of the GOI should have been good for consumers.

However, changes in trade taxes affect only those goods that are tradable, since governments have no machinery to trace trade in non-tradables. The terms 'tradable' and 'non-tradable' need some explanation, particularly since – though they are widely used in economic literature – there is no standardised definition. In general, a good is considered tradable if it can be distanced from its supplier without loss of value. For example, the services of a hairdresser cannot be separated from the hairdresser herself or himself.[15] Although it is assumed that all goods – as distinct from services – are tradable, in less developed countries many goods have traditionally been produced and consumed only locally and could hence be left off the list of tradables. As technology changes, however, with the use of more capital for operations like preserving, packaging and transporting, many more goods like fresh fish have become tradable. In India, products such as grain flour, edible oil or spices and preserves are now being produced by large companies and are sold in packaged form in distant markets. Once an item becomes tradable, it can be traded internationally. Cuts in trade taxes will, in principle, reduce the prices of tradables relative to the prices of non-tradables.

Table 3.1 shows the shares in consumption of the poor and non-poor of tradable and non-tradable goods. It is based on my own rough judgement about what items are still largely being produced for local consumption and therefore are not subject either to sales taxes or to import or export duties. This division however, is strictly temporary and is liable to change very quickly over time. The group 'other non-tradables' is dominated by items such as rent for accommodation, schooling and health-related expenses. The table indicates that cuts in trade taxes have favoured the non-poor because the share of non-tradables in the consumption basket of the poor is relatively large. (Here, the issue is regarding cuts only in levies by the GOI on internationally traded items.)

Table 3.1. Percentage distribution of consumption baskets of different groups of the rural population, 1999/2000

Item	Bottom 30% persons	The rest	All
Food net of tradable items	57.5%	50.5%	49.1%
Tradable goods	19.8%	23.0%	20.9%
Other non-tradables	22.7%	26.5%	30.0%

Source: NSSO, 2001, tables 1R, p. A-17 and 5R, p. A-233.

In the period since 1991, prices of agricultural products, most of which are still not internationally traded except under government licence, have risen relatively faster than those of manufactured goods, which now can be regarded as internationally tradable because there are few controls by the state on their import or export. Table 3.2 shows these trends.

Table 3.2 Price indices of agricultural and manufactured products, 1991/92 to 2002/03

Year/Month	Index of manufactured products	Index of agricultural products	Index of manufactured products as % of index of agricultural products
(1)	(2)	(3)	(4) 2/3 x 100
1991–92	86.4	87.9	98.3
1994–95	112.3	116.1	96.7
1999–00	137.2	159.1	86.3
2001–02	144.3	169.5	85.1
2002–03	148.1	175.3	84.5

Source: GOI, *Economic Survey 1994/95*, Table 5.16, p. 90 and *Economic Survey 2004–05*, Table 5.4, p. 90.

This is what trade theory would lead us to expect: when there are more suppliers (in this case because the good is open for trade by international sellers), competition between them would force prices down as compared to the earlier situation when there were fewer sellers. Tradables, where sellers from all countries are competing, should thus become cheaper than non-tradables, which are supplied only by a few local producers. Therefore, persons who spend a higher percentage of their incomes on non-tradables should be worse off than those who spend a relatively larger share on tradables. In other words, trade liberalisation is likely to have worsened the relative position of the poor vis-à-vis the rich as far as their consumption of goods is concerned.

On the other hand, the recent cuts in trade taxes apply to goods and not to services, and therefore services became relatively more expensive compared to goods. The GOI has, in addition, imposed a flat rate tax on services from which only expenditure on health and education services is exempt. That means that services other than those two are likely to have become even more expensive relative to goods.[16] What impact would these provisions have on the poor relative to the rich?

The National Sample Survey Organisation (NSSO) provides five-yearly estimates of distribution of households by their monthly per capita consumption expenditure (MPCE) and also shows the average amount spent on different kinds of items for each MPCE group. For the year 1999/2000, the picture was as shown in Table 3.3.

Table 3.3. Expenditure on miscellaneous services and on health and education services by different MPCE groups in rural (R) and urban (U) India (in Rs.)

	Per capita monthly expenditure				Total average MPCE	
MPCE groups	Misc. services	Index no.	Education and health	Index no.	Amount	Index no.
R <470	14.0	100.0	17.9	100.0	277.7	100.0
R 470–950	38.9	277.9	53.8	300.6	623.2	225.5
R 950+	137.7	983.6	190.8	1,065.9	1,343.8	483.9
U <500	16.5	100.0	21.8	100.0	381.1	100.0
U 500–1120	57.2	346.7	64.4	295.4	745.1	195.5
U1121–1925	186.4	129.7	150.7	694.5	1,420.5	372.7
U 1925+	517.3	3,133.3	376.4	1,726.6	3,074.9	806.9

Source: NSSO, 2000, Tables 1R 30 and U 30, pp. 36–37 and Tables 7 R and 7 U, pp. 64–67.

It appears that as total MPCE level goes up, people everywhere spend more than proportionately on both groups of services. In rural areas, interestingly, expenditure on health and education rises faster than both total consumption and expenditure on miscellaneous services. In urban areas on the other hand, the increase in expenditure on the latter group of services is much faster than in total consumption and in expenditure on health and education.

One can conclude on the basis of this data that, as shown in Table 3.1, the poor have probably been more adversely affected by relative changes in prices of tradable and other food items; but when one takes into account consumption of various kinds of services by different MPCE groups, and when the incidence of changes in trade taxes and in taxes on services is pooled together, it seems that the urban rich would be paying considerable service taxes. Since expenditure on services goes up faster than on goods in higher income groups, the relief they have received through cuts in taxes on tradables is probably being offset by liability to service taxes, making the overall incidence of central taxes somewhat progressive.

Questions remain about the relative impact on women as compared to men of changes in trade taxes. The Indian data system gives information about the distribution by levels of MPCE only at the household level, which is then divided by the number of household members to work out the average per capita figure of total or item-wise consumption. In other words, the data collected for each of the sample households is of the aggregate spent by the household on a given item and there is no further information about its intra-household distribution. It is therefore not possible to work out the differential burden on women and men from that information.

However, it has been shown that a larger proportion of women are found in poorer households in both rural and urban areas (Banerjee, 2000; Sundaram and Tendulkar, 2004). Therefore any adverse effect of changes in trade taxes is likely to affect a higher percentage of women than of men. Moreover, one of the questions asked at the village meetings mentioned above was regarding the management of household expenses. The majority of women replied that, in the kind of occupations that their family men had been engaged in, incomes had lagged behind the general price rise. So, male contribution to family resources had not been increasing as fast as family expenses; in such situations, it was the women who had to find the means to make ends meet. In rural areas all the women had given up using commercial fuel for cooking and were collecting whatever combustible materials they could find for free. They had also taken up some activities such as keeping chickens or growing vegetables to supplement family incomes. Overall their workload has gone up significantly, particularly since finding free material to use as fuel is becoming increasingly difficult in West Bengal's rural areas.

I had no opportunity to collect systematic data about urban women's reactions to the new situation. In the city of Kolkata, however, more women now appear to be participating in family activities, especially petty trade. They too forage for things to burn; however, in the city, they do not get vegetable waste or wood and are often forced to use waste mixed with plastic or rubber, which is dangerous for their health.

Impact on producers

The impact of changes in trade taxes is not confined to consumers alone; they are of great significance to producers, especially of goods that compete with internationally traded goods either for their inputs or for their markets. India's trade reforms in 1991 were very largely triggered by external factors and not prompted by any careful analysis of the state of the country's economy. Hence, the liberalisation that took place was as sudden as it was drastic and had made no allowance for the existing state of the various productive activities in the country (Goyal, 1996, as quoted by Topalova, 2005). Trade policy reforms thus compelled a very large section of producers of goods to face competition from various unfamiliar directions. As late as 1989/90, the share of goods that could be imported under open general licence (i.e. without government controls) was only 12–15 per cent of all commodities being marketed in India. But between 1992 and 1997, the absolute number of products subject to quantitative trade restrictions by the state went down from 85 per cent to 45 per cent. For international trading, only a few goods mentioned in a single 'negative' list remained protected; all goods outside it could be freely imported (Goldar, 2002). Changes in trade taxes have therefore had a significant but unforeseen impact of on almost all producers of goods in the country.

Trade shocks and poverty

A very large percentage of rural and urban households in India are engaged in production of agricultural as well as industrial commodities for trade, on either a full-time or part-time basis. Many agricultural households, besides producing a staple food crop, also produce a commercial crop such as oilseed, cotton, jute, silk cocoons and fruits including coconuts for their cash requirements. Districts producing commercial crops also have traditional or modern industries for processing those products. All these crops and their processed products are sold on national and international markets. Many more households are engaged in the manufacture of products such as handlooms, handicrafts, coir products and processed foods. In any given area, the manufacture of one of these products is usually the single largest employer of rural labour, especially of female labour, after agriculture. Many of these agricultural and cottage industry products are or can be internationally traded so that their producers, whether cotton growers or handloom weavers, are likely to be affected by changes in trade taxes.

In her research study, Topalova (2005) addressed the very important question of whether the benefits (or costs) of trade liberalisation were spread evenly in all areas. She assumed that benefits of trade liberalisation could be measured by the extent to which poverty levels (head-count ratios and poverty gaps)[17] go down in a particular region. Her hypothesis was that, in the decade following trade reforms, there would be a greater impact (positive or negative) on districts that had a higher percentage of population depending on industrial employment. She therefore classified all districts of the 16 major states of India by the industrial composition of workers in each according to the 1991 census. She found that in rural districts where a greater percentage of the population depended on industries, the head count ratios of poverty over the relevant period went down by a significantly smaller amount than for the average district. In other words, although poverty levels went down (at last marginally) in all districts of India, they went down by a smaller percentage in districts that were more likely to be producing tradables.

These findings presumably mean that industries in India were unprepared for trade shocks and were adversely hit by the policy changes. There are several reasons why these industries are in this vulnerable position. One is that many of these crops and the industrial products based on them are of relatively poor quality, e.g. raw cotton or silk cocoons. Past history shows that, with open trade, demand for these products depends heavily on the supply position of producers of superior varieties from other countries. In years when that supply was down, there was an upsurge in demand for Indian products. Often in the past this had persuaded Indian producers to step up their production in the following year, only to make heavy losses when supply from elsewhere improved. Indian producers do not have adequate information about world production and demand trends, as a result of which they have been hit harder by trade vacillations. Even now this has been the case for cotton producers.

In addition, the GOI had long been protecting many small-scale, cottage and village industries from competition by reserving domestic markets for them and by barring the entry of competing foreign products through trade barriers. But such protective policies had done little apart from offering the units cheap credit and some inputs at subsidised prices. Over time, these industries had come to be dominated by intermediaries, mostly traders, who provided the actual producers with working capital and in return had the first option for buying their produce. This way they tended to push the producers into a state of bondage; the benefits of the facilities provided by the Government to small units went mostly to those intermediaries and left the producers with no resources to invest in upgrading the units. Therefore the value productivity of those units had remained low. When the earlier facilities such as subsidised inputs were withdrawn, the units could not withstand open competition with large modern units of domestic and foreign producers.

Why is the impact localised?

Under standard trade theory, in an open economy these kinds of pockets of poverty would be eliminated by factors of production – land or labour – moving quickly and smoothly to other, growth-prone or 'sunshine' industries; if necessary, labour could migrate to other areas where those industries are located. However, evidence on migration up to 2001 from census records suggests that till then, migration for work even within India was not on a large enough scale to counter the impact of decline of industries in some areas. The household-based survey that I undertook in 2003/04 in West Bengal found that out of 500 households, only 54 or just over 10 per cent had at least one migrant worker (Banerjee, n.d.). Migration of labour has been constrained because of two main reasons:

1 Workers in these traditional industries acquire their skills through family traditions; they have no exposure to other skills or to the basic training (often including schooling) that is required for absorbing new skills. For them, moving to a new occupation always means having to start at the bottom in its unskilled operations.

2 In an average rural district, there are few alternative occupations available that can absorb the redundant labour of another industry. Traditionally, all rural workers who were unable to find other work went into agriculture, even if on a temporary or part-time basis. However, census records for 1991 and 2001 show that during that decade, agriculture in most states had actually been shedding its labour and was obviously not capable of absorbing workers from other occupations (Singh, 2003, Table 8, p. 896.)

Impact on women

In areas receiving trade-related shocks, women are vulnerable both because they themselves may be workers in those industries and also because they belong to the households of such workers. From the recent household survey mentioned above, it appeared that the main strategy of families was for more members to enter the workforce and for all workers to seek additional work whenever available. This strategy required considerable flexibility in the deployment of family labour because of the need to cope with sudden changes in job availability. The survey result showed that it was mainly women who provided this flexibility, which meant that they also took up whatever wage work was available. However, because of their other commitments, their choices in this were limited either to part-time work or to home-based work.

If the time spent on all women's economic or productive tasks (whether market-oriented or not) was added up, then it was sufficiently long to entitle them to be recognised as workers in the official sense. But because they spent time on multiple tasks and could not specify any single task as their principle activity, they usually got left out of the official count of workers.[18] In many areas where traditional industries had collapsed, women took on multiple roles. For example, in Murshidabad area, where silk cocoon rearing and silk reeling industries had been badly hit by the policy of allowing free imports of Chinese silk (cocoons and yarn), women of traditional sericulture families were found working for longer hours (average of nine hours plus) than in any other area in the sample. They continued to rear cocoons, however small their returns, because even when prices of cocoons had fallen the family regarded women's labour as free. Also throughout the year they did piece-rated work of rolling *bidis* (hand-rolled cigarettes). In many families, this work now accounted for more than half the family income. The same was true of women in handloom weaving families of Hoogly district.

In spite of getting some recognition as workers from their families for their money-earning work, women's burden of housework remained unchanged; in almost all families no other member except minor children offered any help and no family had invested in any labour-saving gadgets.

In summary, the shift from trade taxes to direct taxes by the GOI had probably meant that in specific regions, producers of rural tradables had not been able to withstand the increased competition or to shift to other industries and areas. Therefore in those regions, poverty had been somewhat more persistent than in other rural areas. For women in those families, the crisis had led to a significant increase in their daily workload because of the adjustments required in the families' struggle to find alternative sources of income. Nevertheless, in the evolving situation, women had found a new confidence and a voice in family decisions even though it had not led to any reduction in their burden of traditional work as a nurturer.

The switch from sales tax to VAT at state level

At the state level, the most important change in the revenue regime has been a broad consensus between states, tax experts and the GOI to replace state level sales taxes by a value added tax (VAT). West Bengal has now passed the West Bengal Value Added Tax Act of 2003, which became effective from 1 April 2005. After a full financial year of its operation, the West Bengal Finance Minister expressed his satisfaction and claimed that receipts under the new regime have been satisfactory. Unfortunately, it was not possible to substantiate this claim from figures of receipts from budget documents because, as the officials in the state government's finance department explained, necessary changes in the budget procedures had not been carried out as yet and, therefore, the figures available were gross of all sales taxes; separate figures for VAT were not available.

Sales taxation as practised by states until recently was their largest single source of tax revenue. In the year 2003/04, its receipts constituted about 60 per cent of the total tax revenue of the states and were equivalent to about 3.5 per cent of the GDP of the country. It was a tax levied at the point of sale of a manufactured good; services were out of its coverage because the Constitution had clearly laid down that the tax, as assigned in the state list, was to be on manufactured goods only. This had severely limited the growth potential of the tax, since, as noted above, services are the fastest growing sector in the Indian economy.

Ideally, sales tax should be collected at the point where the good is sold to the final consumer. However, because of difficulties in reaching multiple small sellers in distant places, the tax used to be collected at the point of first sale, i.e. at wholesale level, which narrowed the tax base further in money terms. Moreover, state governments had found it politically imperative to exempt essential goods from its coverage and, at the same time, to make the tax rates progressive. And since they also had to raise the yield of that tax to meet their fast-rising need for revenue, state governments had come to levy multiple and steeply progressive rates on different goods. The Report of the Study Team for Reform of Domestic Trade Taxes in India (NIPFP, 1994) observed that, at the time of writing the report, sales taxation in India was the most complex system in the world and hence urgently in need of reform in the interest of both efficiency and fairness. The tax was considered defective for the following reasons:

- Levying the tax at the first point of sale meant that a significant part of the value added in later stages by operations such as packaging remained outside its coverage. It gave scope for malpractice by manufacturers, who left several value-adding operations out of the basic manufacture that then were done later by their subsidiaries.
- In this process, trade margins got left out of the tax coverage, which particularly favoured richer consumers because these margins could be very large for luxury goods.
- Because the tax was levied at an indeterminate stage of production, it created unintended distortions between goods produced by different producers who were using different methods.
- To counter these kinds of anomalies, many states levied a turnover tax that added a further burden on the taxpayer and often got transferred to the consumer in the form of higher prices.
- The base of sales tax was essentially narrow because of not taxing services.
- High rates gave an incentive for tax avoidance and, because this tax was collected at a single point, the Government lost the entire amount of tax that was due from those items.

- Sales tax was levied on some inputs as well as on capital goods. Some states set the rates of tax for those items somewhat low; nevertheless, in the assessment of taxation on the final product, there was no recognition or refund of the tax amount that had already been paid on capital goods. This had a cascading effect, in the sense that in the sales of the final good, those inputs and capital goods were being taxed once again. This meant that the ultimate prices charged to the consumers were higher.

VAT is also a tax on sale of goods (it too excludes services). However, it is a method of collecting the tax in instalments at several stages. The value added at each stage of production is the difference between the sale value of the product and the cost of the inputs that the producer had brought. In principle, the total tax amounts collected under VAT and under a retail sales tax would be identical, because the retail sale value is equal to the sum of value added at different points.[19] The tax due may be calculated either on the full sales value (and then the tax paid at earlier stages can be deducted to get the net liability of that producer); or, tax can be calculated only on the value added by that producer. If the tax rate applicable at all stages is the same, then the amount due would be the same in either case. Theoretically VAT has the following advantages over sales taxes:

- VAT is recommended for its neutrality, i.e. its non-interference with the decisions of economic agents about what to produce, by what technology and in what kind of production organisations. Because there is no cascading of the tax, it does not matter how much of the final value is added and taxed at each stage. There is therefore no incentive for vertical integration of units only to save on tax liability.
- Provided VAT is charged at the same uniform rate at all stages of production, it is easy to calculate at any point how much tax has already been paid. In other words, tax administration becomes transparent and there is no uncertainty about tax liability.
- Because producers can claim credit for taxes paid on their inputs, they have an interest in demanding invoices and tax records from their suppliers. This means that suppliers have to get themselves registered and keep proper records to satisfy their customers. Thus a much larger section of the economy comes under official recognition, which helps in collection not only of VAT but also of other taxes such as trade licenses, personal income taxes and corporate taxes.
- While avoiding sales tax was easy because of the single point of collection, with VAT it is more likely that some part of the total value generated will be netted for taxation.

In practice, the VAT regime recommended by the Empowered Committee under the Finance Ministry of the GOI and its application at state levels is somewhat different from the theoretical model. Ideally, there should have been a uniform VAT levied by one authority for the whole country. This would have removed several problems that have always haunted India's indirect tax practices. One such problem is of compatibility between central excise taxes, central sales taxes and the sales taxes and turnover taxes of different states; this is especially true in the case of inter-state sales. However, politically and practically, it was not possible to impose one centrally administered VAT; sales taxes are after all the lifeline of state finances and state governments would not have agreed to give up this sovereignty. Ultimately, as a compromise, each state was allowed to pass its own VAT law and the GOI agreed to phase out its central sales tax as well as its excise duties. The Centre is to be compensated for any possible loss from such measures by a reduction in its allocations to state governments.

VAT as practised in West Bengal

VAT as levied in West Bengal has four rates besides the exemption given to several essential goods. Exporters are taxed at zero rate,[20] gold and bullion are taxed at 1 per cent, inputs and capital goods are taxed at 4 per cent[21] and the rest, i.e. all taxable goods, are taxed at 12 per cent.

For the purpose of this paper, the more interesting question is about the treatment under VAT of purchases of capital goods by producers. Like all taxes on inputs, those on capital goods are also meant to be offset against their own tax liability. However, capital goods are lumpy (i.e. not divisible, such as machinery for making cars) and in any one year the price of a capital good and the possible tax credit to be claimed against it can be very high. On the other hand, that capital good is likely to be used for several years. The unit buying it may find that its own tax liability in the year of purchase is not sufficiently large to be able to use the entire amount of tax credit due. So the West Bengal Act provides that, for capital goods costing up to Rs. 1 crore (10 million rupees), the entire tax credit can be used in one year or, if this is more than the purchasing agent's own tax liability for that year, it can be carried forward to the next year. In the case of capital goods costing more than that amount, the credit is to be set off in four half-yearly instalments (i.e. in two full years).

This is a major change from the earlier sales tax system, where taxes paid by the sellers of a capital good were partly or fully included in its price to the purchaser. Because the final good produced with the use of the capital good was also taxed, the value added to it by the use of the capital good was taxed again. Over the life of the capital good, its entire value thus used to be taxed twice. The new system distinctly favours those using more capital goods than before, which for reasons set out in the next few paragraphs is likely to go against today's informal sector workers and especially women among them.

Impact of shift from sales taxes to VAT on the poor and on women

Because VAT is basically the same as the earlier sales taxes, fiscal experts generally feel that there is unlikely to be any difference in the impact on consumers – except that, since VAT does not have a cascading effect, it is generally expected that prices for consumers would be lower, thus raising their welfare. Moreover, because VAT is expected to be more difficult to avoid, VAT rates can be lower while the same amount of revenue is obtained. This will also increase the welfare of final consumers. Since essentials in India are exempted from all sales taxes including VAT, women in poorer households will continue to enjoy this benefit. A reduction in rates of taxes on consumption expenditure would favour the rich more since they spend a larger percentage of their incomes on non-essentials.

However, this shift from a retail sales tax to VAT may have a considerable impact on workers, especially on those in the informal sector. There is a close association between poverty and the informal sector because, by definition, terms of employment for the 85 per cent or so of workers engaged there are nowhere comparable to those in the formal sector. In particular, women in India are unable to become economically empowered because over 94 per cent of employed women work in informal activities where they usually earn less than the official minimum wage and have no security of employment or any other worker benefits. Records show that, in the decade or more since India adopted the new economic policies, the share of the informal sector in the country's workforce has been growing.

Although the informal sector is thus by far the largest employer, and is also responsible for producing 60 per cent of the GDP, there is no official recognition or record of the workers operating there. Owners of informal units and their workers are not assessed for direct taxes at the source of their incomes and they do not always have a trade licence. The sector, however, is closely linked with the mainstream or formal economy in two ways:

1 Informal units are part of a vertical chain of production operations. They may either use the output of some formal sector units (e.g. handloom units in the informal sector buy yarn from formal sector mills) or be engaged in producing goods that are then transferred to formal sector units and sold under the latter's brand name (e.g. footwear may be made by small producers and then finished and labelled as brand name products).

2 Units in formal and informal sectors often produce near substitutes for each other's products, which then compete for custom in local, national or international markets.

In general, the two kinds of units use somewhat different technologies for producing similar products. In the formal sector, units use relatively more capital per unit of labour. Informal sector units generally use a more labour-intensive technology but manage to stay in competition by paying lower wage rates, keeping down their overheads as well as charging lower prices for their products.[22]

VAT and the informal sector

It was noted earlier that substitution of VAT for earlier sales taxes has removed the cascading effect that the earlier measure had on purchases of capital goods. Now, producing firms that invest in new capital goods can get credit for the sales taxes paid on those goods; this means that the relative prices of capital and labour change in favour of capital, making it relatively cheaper for firms to switch to more capital-intensive technologies and to substitute capital for labour. At the same time, because of the reduced tax liability, the seller would be able to sell the final product at a lower price than before. Informal sector units, which had so far managed to compete by charging lower prices than the other units, would now have to lower their prices further if they are to stay in business.

In addition, an important aim of the Government in switching to VAT is to bring more and more activities and producing units under the tax network so as to enhance tax receipts by broadening the base. With VAT, a unit can get credit for taxes paid by their sellers on those inputs it purchases, provided it can produce an invoice that shows the amount of taxes already paid. This gives them an incentive to buy inputs only from registered units. Since unregistered sellers of inputs do not pay any tax at the time of their sales, they would, in principle, be able to charge a lower price for their goods than the registered sellers, thus countering this incentive for buyers. However, to circumvent this difficulty, the West Bengal government has made a further provision: if a registered producer buys inputs from an unregistered seller, then the buyer has to pay tax at the standard rate charged on that input. This amount, however, cannot be set off against the user's final tax liability. In other words, buyers are discouraged from buying from unregistered units because if they do, they are liable to pay an extra, non-refundable tax amount. Unregistered units can thus stay in business only by further lowering the prices that they charge for their products.

These two provisions, taken together, mean that over time more and more activities are likely to come into the registered sector, expanding the tax base in the economy and permitting the collection of the same amount of tax receipts from lower rates of taxes. Changeover to more capital intensive technologies will further mean that labour productivity will go up and workers will be in a better position to get organised and bargain for better work conditions.

However, there is a strong possibility that the workers who were previously engaged in informal units may not be able to manage that switchover. There are several reasons for this. First, several studies (Papola, 1981; Banerjee, 1988) have shown that informal sector units are often owned by self-employed workers who are severely limited by their lack of adequate capital resources. In the changed tax regime, it may not be feasible for them to cut down further on the prices they charge or the wages/earnings they pay themselves. Nor will they be able to change over to other technologies, given their initial handicap of lack of both human and financial capital. As a result, they are likely to be replaced by new formal sector units working with a different technology and probably with a somewhat larger scale of production. Unless demand for the products increases fast, there will also be a cut in the total employment in that industry because of the shift to production methods that use less labour per unit of production than before.

Second, as mentioned before, many of the informal sector units, especially of traditional artisans, are tied to intermediaries and traders. These intermediaries have never been interested in making long-term investments in these industries, and past experience suggests that if they find that returns on products of the informal units are no longer adequate, they would prefer to move out of those industries, thus pushing the units into a bigger crisis.

Third, even if the same units were to be modernised, workers who had earlier been employed in them may not have the skills required to work with the new technologies. In particular, there is a long history of women workers losing their jobs when industries change to more mechanised operations (Banerjee, 1985, 1998; Sen, 1998). This is partly because the workplace moves from homes to factories and it becomes necessary to put in regular and continuous hours. Or it can be because, with higher productivity, wages for the jobs go up and men take them over. The jobs women held admittedly were usually of poor quality, with low pay and no work security. But since any kind of wage earning jobs for women are scarce in this region, losing the existing ones may have serious consequences for the workers.

User charges

With the growing resource crunch, governments in India are looking for new sources of revenue and, alarmed by the country's high level of annual fiscal deficit, international development agencies have been encouraging their attempts. One suggestion, based on local government practices in the United States, is to charge the consumers user fees for utilisation of specific government services. User charges can be collected when the government provides an identifiable unit of service to an individual (hospital bed for one day to one patient, parking space to one car for one hour, and so on). This is actually not a new idea even in the Indian context because for a long time various governments have been charging tolls for use of bridges and roads and selling tickets for travelling by publicly run railways, buses and ferries. There are charges for car parking and fees for entry to certain gardens or parks maintained by the state. Governments in India are now trying to apply the principle more widely by putting charges on some basic services it provides to the people.

Collecting these charges serves several aims:

- It can control the misuse and wastage of a scarce public service and ration its use according to the intensity of the demand of potential users.
- In case of an essential service where government is unable to cater to the full demand, public supply of even a part of the service at reasonable prices can act as a check on overcharging by private producers.
- For provision of a particular service, user charges do not interfere with the benefit principle as do taxes because they are paid only by users and not by all residents. Most governments, particularly in India, find that their tax system is not sufficiently wide-based and flexible to enable them to maintain progression in the overall fiscal regime and yet find enough resources for their needs. In this situation, a cost-based user charge causes less distortion in the overall public finances than would additional indirect taxes that yield the bulk of public resources.

The state can resort to user charges provided:

- The concerned service is not a public good and the actual user can be identified. If it is a service like eradication of mosquitoes, for example, then everybody in the locality will benefit. It would not be possible to separate the beneficiaries from the others.

- The service is not a merit good, i.e. there are no external benefits from its universal provision. For example, vaccination against infectious diseases cannot be financed by user charges because it is important that all persons, whether or not they are willing to pay, are covered if the disease is to be eradicated.
- The service is not a constitutional or statutory obligation of the government.

Admittedly, levying fresh user charges on a service that had so far been free will have a discriminatory impact on the poor; the amount spent on it will be the same for all but will form a larger percentage of the income of the poor than of the rich. However, if the government was earlier financing the service by raising taxes and now can reduce the tax burden to the extent that the expenses are now financed by user fees, the overall effect is intended to be more equitable, because for reasons mentioned before, the taxes to be cut will be the indirect taxes whose burden is not spread very equitably.

Since independence, as a part of its vision of the country as a welfare state, the GOI used to heavily subsidise several basic social services, particularly education and health. However, after 1991, with the new economic policies and their growing emphasis on fiscal discipline, there has been a move towards economic pricing of some of these services. The GOI has been successful in hiking up fees in its prestigious institutions for technical and management education. However, similar attempts to make all higher education economically priced have proved to be very unpopular.

User charges for health services

In the same way, governments are now trying to reduce the subsidies in provision of some curative health services. In order to avoid popular protests against the measures, these have been introduced quietly in selected sections.

User charges at the AIIMS

The prestigious All India Institute of Medical Sciences (AIIMS) in New Delhi[23] was set up under a parliamentary act in 1956 stipulating that its expenses would be met from the Central budget. The institution has been used simultaneously for two purposes: on the one hand, it was supposed be a centre of excellence for providing top quality services and teaching facilities in the country; and on the other, it was to provide good health care for all who came there to seek it. For many years, the institution was used by people of all classes and, even if it involved long waits, the average Indian benefited from it.

The current policy, however, has a somewhat different focus. The institution is poised to be a state-of-the-art – what is called a five-star, super-speciality – hospital for those who can afford the new steep charges. On the expenditure side, it is reported that allocations to medicines and food for in-house and out-patients have been cut in favour of expenditure on research and machinery. This has meant that patients from middle and low-income households no longer have access to services there.

Under the new regime the charges are expected to yield about Rs. 120 million as against the annual budget of about Rs. 3,000 million provided for the AIIMS by the GOI. In other words, the charges are not really to raise revenue but to ration the service, and to reserve it for those who can pay the steeper prices. Thus, the services continue to be heavily subsidised, but whereas previously they had gone to people on a first-come, first served basis, they now go to a limited group chosen on the basis only of their ability to pay. There is no way that the system can admit considerations of ability to pay or urgency of need or even the seriousness of the complaint. Thus the effect on the incidence of GOI budgetary operations is likely to be regressive because the subsidies given to AIIMS service users will henceforth go exclusively to those who can afford the charges.

It can be argued that the AIIMS was set up mainly to reach excellent standards in medical services and teaching, and the present policy does help to fulfil this aim by investing more for the best equipment and research. In that case, however, the user charges are neither required nor warranted; the basic purpose would be served equally well if the services were to be rationed out among those who come there on a first come, first served basis or through a referral system that sends to AIIMS only those patients that need advanced medical care.

User charges in West Bengal's health services[24]

West Bengal's policy about user charges for health services is far from clear and there are many anomalies seen in practice. For example, the health department claimed that there were as yet no charges levied in rural areas, but many women attending our meetings told us about the charges they routinely pay. For urban hospitals, the health department issued a notification in March 2002 of their list of their charges for various services in public hospitals – though most patients do not know what their liability is or what they are entitled to in return for paying the charges.

The West Bengal system has the following problems:

- The rates are set at a fairly low level and can yield only a small fraction of the costs of providing the service. In the year 2003/04, the budget estimate for revenue expenditure on urban hospital services was Rs. 5,547.50 million, whereas the estimated receipts from patients were only Rs. 191.56 million.
- Hospital visits revealed that, in spite of the charges, the rush for services was unabated; in rural areas too, the women we met at our meetings (see Appendix 2) were quite ready to pay the charges provided they got the services. In other words, the charges appeared to be too low to deter service seekers. In fact, if the aim of levying the charges was to weed out at least the malingerers, then that was being done more by the frustrating queues and delays in reaching doctors. But this meant that genuine patients suffered equally.
- Paying the fee does not guarantee getting the specific service. Instead, patients increasingly find that after payment they still have to obtain the medicines, blood or

pathological tests and x-rays that have been prescribed from the free market at much higher prices.

- By charging heavily subsidised prices for these services and then failing to provide them to all, public authorities add an unnecessary element of arbitrariness and unwarranted discrimination among patients. The scarce items are distributed according to no clear criteria, which means that the large government subsidies that fund the services go to patients who are selected according to no justifiable principle.
- Patients have no way of protesting against these discriminations and that creates a feeling of resentment.
- Since user charges are collected from actual users against provision of some service, the receipts should, in principle, be recycled into running and improving those services. However, the West Bengal government has recently decided that 40 per cent of the receipts will go to the state's general budget and the rest will be put in a fund to be monitored by a committee called the *roogy kalyan samity* (committee for the welfare of patients), which is to decide on ways to use the fund for patient welfare. Patients do not have representation on the committee.

Health as a basic right

According to the Constitution, citizens have a fundamental right to life. Whether or not that implies a right to a healthy, disease-free life is a debatable point but, for a long time, the GOI had accepted the responsibility of providing citizens with health services, and it was in the spirit of that vision that government hospitals were set up in most districts and primary health clinics were established throughout rural areas with referral connections to higher-level service providers in the public system. Over time, however, governments have been unable to assign adequate resources to these services. The amount of government expenditure on health services is now less than 1 per cent of GDP, whereas the Common Minimum Programme of the current coalition party in power at the Centre had talked of allocating 3–4 per cent of GDP towards health services. The new move to collect user charges or to encourage a greater role for the private sector in the provision of health services is a reflection of the state's failure to fulfil its earlier promises.

Poverty and health services

The move to fund part of state expenditure on health services through user charges raises a major moral issue. On the one hand, the quality of private sector health services in India is very good; however, that is not available to the poor. And recently, these hospitals and clinics are increasingly being shaped to provide state-of-the-art services for attracting medical tourists from among first world patients. The expenses involved in reaching high standards of excellence and the growing competition from consumers from among the world's rich are together pushing the prices of private health facilities out of the reach of the average Indian. For them, subsidised health services provided by the state are the only option.

Moreover, there is a close connection between poverty and ill health. The poor are more prone to diseases because they do not have access to clean water and proper sanitation. Many of the jobs they are engaged in for a living are hazardous but, as informal sector workers, they get no protection or insurance against those hazards. For an average family, a major illness is a sufficient cause for plunging it into temporary or permanent poverty. This is not only because of the expenses of treating the illness; it is also because if the patient is the main earner, then his/her loss of days of work also means a loss of income for the family. Among such workers in the informal sector, a significant number of males migrate for work singly; some of them contract HIV and carry the infection back to their wives. HIV and AIDS are expensive to treat and, in time, completely incapacitate the adults – including the workers in the family (Kapur Mehta and Gupta 2005). If the state withdraws from providing the necessary services at subsidised rates to the poor, then these families are doomed to penury for generations.

Women and health services

For women of poor families, it is doubly important that the state continues to provide health services at subsidised rates. First, if the male earner falls ill, then the responsibility of looking after the patient, finding money for his treatment and at the same time supporting the family falls entirely on the woman, who herself runs a high risk of being similarly infected. On the other hand, discussions in the village meetings indicated that women and their families set a low priority on the health needs of women themselves and relied mostly either on public services or on village 'quacks' for any medical help. If the services of trained personnel under the public health system become more expensive, it is certain that women will increasingly rely on unqualified practitioners for their treatment. There has to be some clear thinking on the part of policy makers about these consequences before they decide to impose across the board user charges that cover even the running costs of health services.

Second, women need health care in connection with their reproductive roles. India's maternal mortality rates at the turn of the century were still unacceptably high at 409 per 100,000 live births; West Bengal's rate then stood at 266 and the state ranked 8th in the country (Govt. of West Bengal, 2004/05, Table XV, p. 311). The main reason for these high rates – as identified by the Planning Commission in its draft Approach Paper for the Eleventh Plan (GOI, 2006) – is lack of expert help for women at the time of delivery. In 1998/99, for India as a whole, only about 40 per cent of births were with a safe delivery procedure (i.e. with help from trained health professional such as a doctor, nurse, midwife or health visitor). In West Bengal the percentage was slightly better, at 46 per cent. Since most urban births in the state were in hospitals, the rural position was no doubt much worse than that indicated by the state level average. However, private sector professionals would find it unprofitable to reach women in remote, scattered hamlets unless they could charge high fees.

In general, women find it more difficult to seek help for health problems because families do not encourage them to forego work for morbidity or to spend money for treatment. In the Rapid Household Survey undertaken under the Reproductive and Child Health programme it came out that about 18 per cent of men reported having any symptoms of sexually transmitted diseases or reproductive tract illnesses, but of these 51 per cent had sought treatment. Among women, 30 per cent reported having at least one symptom of these diseases, but only 30 per cent had got treatment (Ghatak 2005, p. 45). Women also have difficulties accessing treatment because the clinics and hospitals are situated far away from their homes and also involve long waits and repeated trips. This means that women normally find it harder to get professional health services than men although they may need them more.

In reality, the user charges that the West Bengal government is collecting are quite low, and in all our interviews and meetings we found no resistance from women about paying them. However, the state, in diverting that money to other purposes than improvement of health services, has once again failed to take account of the needs of the people at the grassroots. The women we met desperately want public health services to be extended and run efficiently without the corruption and negligence that is built into the system at present. They also want roads and transport to enable them to reach the clinics. Alternatively, they want mobile clinics and visiting professionals to come to them rather than their travelling long distances. In short, they want more of a government presence and not less, even if it means paying higher user charges.