CHAPTER X

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10.1 Excise duties mobilise the maximum tax revenue for the national exchequer in India. But the vast coverage, structural complexities and methodological and data problems discourage analytical approaches to evaluate the impact and efficiency of the tax structure as it developed over time. In this study, an attempt is made to examine the important characteristics and interactions of excise duties in a comprehensive framework using unconventional but appropriate methodology depending upon the type of data available and analytical possibilities. The findings of the study are utilised in the formulation of a rational and simple tax structure which can conveniently replace the existing distortionary one and also ensures more efficient and effective performance in terms of the major tax objectives.

10.2 At the outset, an overview of the evolution of excise duties has been presented tracing the extension of the tax base and revision of rates from the inception of the modern system of excise in the pre-independence period. The study shows that the tax coverage has not been extended in a systematic or selective manner. Several commodities yielding negligible revenue have been brought into the tax net since independence with consequential increase in the cost of administration and creation of complexities in the tax structure. It is seen that the revenue from specific rates
is still predominant which makes the tax structure less responsive to income and price changes. Another trend noticed is that there has been increasing dependence on inputs and capital goods for mobilising additional revenue particularly in recent times. The frequency of rate revision is found to be more in the post-independence period and that in the case of consumer goods having differential tariff, the trend is more pronounced. The overall picture that emerges from the study of the evolution of excise duties indicates that there is no rational or scientific design or basis for the development of the tax structure and that it got extended on an ad hoc basis as and when the need for additional resources arose particularly during the post-independence period.

10.3 After examining the evolution of the tax structure, the study focusses on the structural complexities and their consequences on tax compliance. It is seen that the extra-revenue tax objectives included in the fiscal policies during the developmental phase have been primarily instrumental for the creation of differential tariff and consequential structural complexities. It is noticed that the differential approach in tax treatment to different sectors of the industry and classes of the population adversely affects the revenue potential and open up fresh avenues for evading tax liability. The administrative set up for ensuring tax compliance has also been found to be extremely inadequate for enforcing the requirements of the expanding tax structure and thereby securing tax compliance. As a result, tax evasion
has become more rampant and pervasive particularly in the case of manufactured goods. It is also seen that the proprietary concerns in the small and medium sectors are more prone to evasion than units in the organised sector.

10.4 The study of tax structure complexities is followed by a thorough analysis of the various important aspects of excise revenue such as growth, composition etc. at different levels. It is noticed that the yield of excise revenue increased considerably since independence and that presently it is the largest single source of revenue for the Central Government. The analysis of commodity-wise revenue show that about 50% of the total excise revenue is collected from inputs including intermediates and capital goods. The large scale input taxation creates what is known as the cascading effect that distorts the tax effects in an unpredictable manner. It has also been brought out that 26 tariff entries out of a total of 141 account for 76% of the total excise revenue whereas 51 commodities contribute only 1.60%. It is also seen that out of the 26 high revenue yielding tariff items, 13 are having specific rates. Certain commodities having consistent growth rates are also identified for the rationalisation exercise. The revenue has also been examined in terms of the nature of assessment and the rationale for the heavy dependence on specific rates of duties.
has also been studied in detail for exploring the possibilities of a complete switch over to *ad valorem* rates.

10.5 The analysis of the revenue is thereafter shifted to the question of responsiveness of excise duties to income and price changes. It is noticed that the excise revenue is not income elastic in spite of the intensive tax efforts during the plan periods. Commodities having *ad valorem* rates are found to be more responsive to price changes. The low elasticity of overall excise revenue is attributable to some identified commodities having consistently low growth rate. Partial elasticity estimates also confirm the finding that the excise revenue is less responsive to price than income which again points out the need for conversion of tax rates. It has also been indicated that restructuring of excise tariff is absolutely necessary for making it responsive to the ever increasing revenue requirements of the country without causing distortions in the economy through constant rate and base changes.

10.6 From the distributional point of view, the question of tax incidence assumes great importance in the Indian context. The tax incidence literature has been extensively reviewed and some broad approximations are also obtained regarding the progressivity of excise duties. It is noticed that there has been more progressive trend particularly since independence as the incidence on essential consumer items has declined considerably inspite of the tax efforts.
10.7 An empirical framework has been used to study the price adjustments that follow the tax changes. The main conclusions are that the tax burden is generally shifted forward to the consumer almost instantaneously. The quantum of tax shifted depends on the nature of the commodity, the amount of duty, demand and supply elasticities etc. In the case of commodities already having excessive duty burden, it is observed that only a portion of the tax gets shifted to the consumers and that a part is absorbed as a reduction in the profitability of the firm.

10.8 As a corollary to the analysis of price effects, tax induced changes in the production levels have been examined in detail to find out a possible correlation between the tax and output. The conclusion is that in the case of certain commodities, the tax may induce changes in the output levels depending on the pre-tax production pattern. However, apart from this micro-level indication, no firm trends are available in this regard in view of the interaction of several extraneous factors that control production parameters.

10.9 Finally, the findings of the analysis of the various aspects of excise duties are brought together and examined in the context of optimal tax theory for evolving a theoretical framework for the rationalisation of excise tax structure. A rational tax structure has been formulated with 23 specified commodities and one residuary entry for all unspecified goods. Optimal tax rates obtained for the restructured tax base have been adjusted for the requirements
of various socio-economic tax objectives which are indicated in the evolution of the existing tax system. The rationalised tax structure is then simulated over a period of time to evaluate its performance in terms of revenue. It is also ascertained that the proposed tax structure will be much more efficient and responsive than the existing one and that it will be possible to obtain better tax compliance and thereby minimise the scope for tax evasion. Since the probable revenue from the restructured tariff is definitely more than the present excise revenue, there should not be any reservation for introducing this alternative, if necessary, with marginal modifications for accommodating other considerations. It is also suggested that similar exercises may be undertaken for other commodity taxes for recasting them so that the efficiency of the entire tax system in the country can be raised to the optimal levels.