PREFACE

In recent years, the emergence of a number of political and economic changes has given rise to new awakening of interest to re-examine the Fiscal Federalism. On the economic front, a greater role assigned to the market in resource allocation and on the political front, the transition from a period of one party rule at the Centre and State levels to that of coalition government and locally dominated regional parties has given rise to confrontational politics between the Centre and the States.

In a federal set up, governmental activities and powers are distributed among various layers of government such as Central, State and local governments. India is a quasi-federal set up where both Centre and States (including local bodies) are allocated tax and expenditure powers so as to meet the growing needs and diversified preferences of people. However, while allocating the powers between the Centre and the States, Indian Constitution has assigned most of the buoyant sources of tax revenue to the Central government and expenditure functions to the States. This has resulted in a mismatch between the revenue sources and expenditure functions and is called fiscal imbalances. These imbalances may be vertical i.e problem of varying fiscal strength across different layers of government (Centre and State) and horizontal i.e among different jurisdictions at each level of government.

Taxation is considered to be the most important source of revenue for a government in a developing economy. Taxes may be Indirect or Direct depending on the incidence of the tax. In Chapter I an effort has been made to analyse the relative significance of both direct and indirect taxes in the total tax revenue of Centre and States. However, it is concluded that the share of indirect (commodity) taxes in the total tax revenue of Central and State government is substantially larger than that of direct taxes.

Out of the central taxes, excises were the most important revenue-generating source for the Central government. While out of the different State taxes, Sales tax occupies the prominent position.

Apart from the problem of mismatch of tax and expenditure powers of Centre and State government, the two important commodity taxes i.e excises and sales tax levied by both the levels of government has caused distortions and inefficiencies in the tax system. Some of these basic problems confronting the Indian commodity tax
system are discussed in this chapter. These include cascading, vertical integration of the firms, inequalities, tax evasion etc.

Chapter II then, provides an overall perspective on commodity tax structure and reforms with reference to India. The Chapter gave the conceptual framework, which has guided this study. It discusses certain issues, which are related to both federalism and independent to Centre and State. These issues relate to lack of coordination in the fiscal decisions of both levels of government i.e Centre and State that resulted in conflicts in the form of fiscal imbalances and overlapping of tax bases.

In Chapter III, an attempt has been made to analyse the theoretical aspects of fiscal federalism and indirect taxation in a federal country. This studies an ideal tax system, which requires uniformity in its structure based on equity and efficiency considerations. However, the partial equilibrium analysis demonstrates the non-desirability of uniform rates. When the tax is imposed, the price gets distorted and causes efficiency loss. Then to increase efficiency in the tax system, the equity consideration is affected in the process. Various models are considered in this regard.

Apart from uniformity in the tax system, another aspect that is taken into consideration in a tax system in a federal country is harmonization of broad taxes (like union excises, sales tax, service tax etc.). Tax harmonization is adopted to overcome the problems of overlapping of tax bases due to the federal fiscal arrangements provided in the Constitution.

Adoption of Value Added Tax (VAT) as prevalent in most West European countries is considered to be a most important solution to the problems of Indian commodity tax system. In fact, almost all-successful tax reforms are associated with the introduction of VAT and by now 140 countries had comprehensive VAT.

However, such a system required a coordinated effort on the part of Centre and States. Through negotiations they can form a uniform tax base for both the levels of government.

Then, in the next two Chapters a comprehensive study is done of the two most important revenue generating taxes for Union and State government’s i.e Union excises and Sales tax. Also, an attempt is made to study how both these taxes are transformed into CenVAT and State VAT both the levels of government. In Chapter
IV, a detailed analysis of the Excise taxes: its genesis, development, significance, trends and reforms is attempted.

In Chapter V, an overview is done of the system of State sales tax: its significance, trends, issues and reform measures. Buoyancy and growth rate calculated for the two taxes concludes that out of the two commodity taxes: excises and sales tax, sales tax were a more buoyant source of revenue. In this Chapter an attempt is also made to examine the Central Sales tax (CST) and Services tax.

Chapter VI broadly outlines the various reform measures initiated by different study teams and committees set up by the government to overcome problems confronted by the commodity taxes (specifically, excise duties and sales tax) in the Indian economy. The foundation of these reform measures was laid down with the publication of Report of Taxation Enquiry Committee, 1953-54. Other major Reports were Report of Indirect Taxation Enquiry Committee, 1978 paving the way to introduce MODVAT on commodities at manufacturing level (UED) in 1986. Subsequently, MODVAT was converted into CenVAT in 2000-01. The second Report is Domestic Trade Taxes which was instrumental in introducing VAT at State level by replacing sales taxes. Both these forms of taxes at Central and State need a lot, i.e. a comprehensive VAT is required. The ultimate solution seems to be Goods and Services tax (GST) i.e merging CenVAT, State VAT Service tax into a single rate. The Union Finance Minister Shri P. Chidambaram has also announced in his Budget speech (2006), his intent to introduce GST from 2010.

Then, in the final Chapter VII, an overall review of the thesis is presented in a summarized form.