Economics Class 04

17th July, 2023 at 9:00 AM

TAXATION: CONTINUED (9:00 AM):

Tax Evasion:

- It is illegal and an escape from paying taxes.
- Higher tax evasion will yield lower tax revenues for the government.
- **For example-** cash payment in high-value transactions like land deals.

Tax Avoidance:

- It is a legal mechanism to avoid tax.
- Corporations use tax loopholes to shift profits from the base/source country to a **Tax haven** through **Base Erosion & Profit Shifting.**

Tax havens:

- These are the countries with liberal tax rules where the source of money is not questioned.
- Some examples are Mauritius, the Cayman Islands, Cyprus, Switzerland, etc.

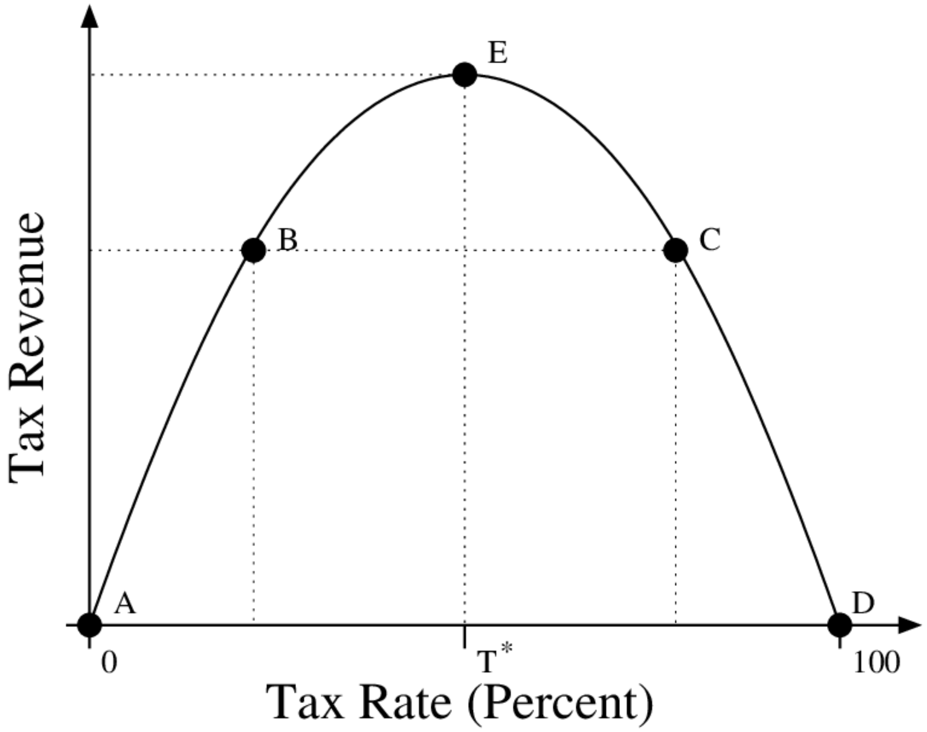
Shell Company:

- These are the companies used for converting black money into white.
- These companies are generally not interested in the front-end business.

Base Erosion & Profit Shifting:

- Base erosion and profit shifting (BEPS) refer to tax planning strategies used by multinational enterprises to exploit gaps and mismatches in tax rules to avoid paying tax.
- Companies will shift their profits from country A where they do major business, and show that they are earning profits in country B.
- Where B will have a lower tax rate than A, even if the country does most of its business in A.

Laffer Curve:

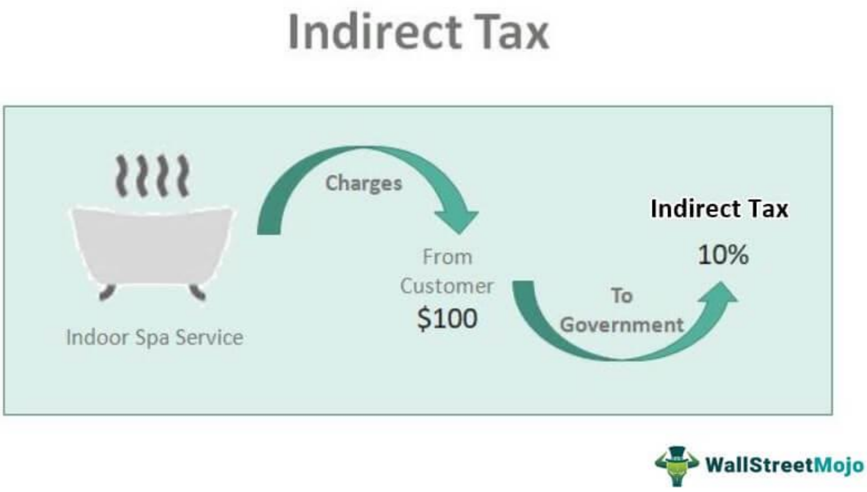
- The curve talks about the relationship between tax rates and tax revenues.
- As tax rates increase, tax revenues also increase up to a certain point.
- Beyond the point, further increase in tax rates goes against tax revenues.
- 

Types of Taxes:

- **Direct Tax:**
- The burden of the tax cannot be shifted.
- The tax has to be paid by the person/entity on which it is levied.
- The impact and incidence of the tax are on the same point.
- **For Example-** Income tax, Corporate tax(Income tax for corporates), etc.

Indirect Tax:

- The burden of the tax can be shifted.
- The impact and incidence of the tax are at different points.
- **For Example-** GST, Customs duty, etc.



- If we pay income tax, we are both at the pace of incidence and the place of impact.
- If we pay GST to a hotel, the hotel will deposit the GST to the government.
- In this case, we are at the place of incidence, while the hotel is at the place of impact.

PROGRESSIVE TAX (9:30 AM):

- Progressive taxes are based on the principle of equity.
- As the income or profit increases, the tax rates also increase.
- It imposes a lower tax rate on low-income earners than on those with a higher income.
- The rationale for a progressive tax is that a flat percentage tax would be a disproportionate burden for people with low incomes.

	A	B	C
1			
2	In $		
3	Income	Progressive Tax Rate	Tax Amount
4	10,000.00	10%	1,000.00
5	30,000.00	15%	4,500.00
6	60,000.00	20%	12,000.00
7	90,000.00	25%	22,500.00
8	1,20,000.00	30%	36,000.00
9			

Regressive Tax.

- It refers to that tax structure where people with low income end up with high taxes.
- A regressive tax is a tax applied uniformly, taking a larger percentage of income from low-income earners than from high-income earners.

Tax Exemption:

- This refers to an exception from paying tax till a certain income.
- **For example,** if there is no tax levied on an income up to 2.5 lakhs, then we will say that income up to 2.5 lakhs is exempted from taxation.
- If there is a tax rate of 5%, along with **tax rebates**, till income of 5 lakhs, and someone's income is 6 lakh.
- He will not be taxed 5% of 6lakhs, but 5% of (6-2.5 lakhs, because 2.5 lakh income is exempted), along with some tax rebate.

Tax Rebate:

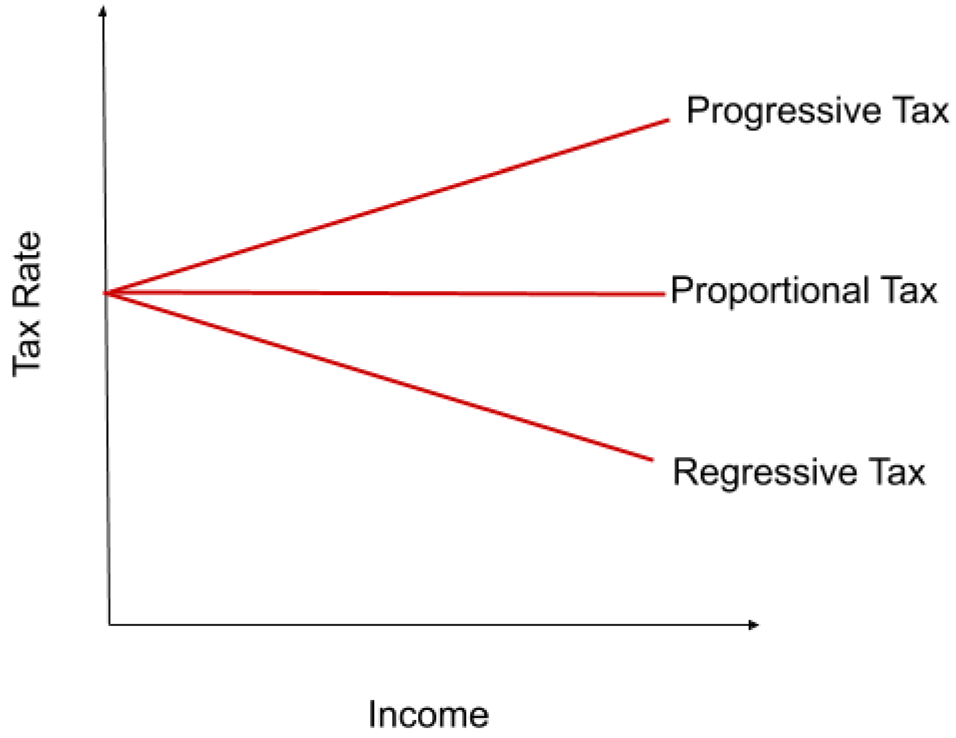
- This refers to the relief that can be claimed to reduce the tax to be paid.
- In income tax, the exemption is across all the slabs, but tax rebate is applied to the lower-middle class only.
- In the above example, if my income is four lakhs, I am eligible for a tax rebate.
- If my income is 5.1 lakh, I am only eligible for tax exemption up to 2.5 lakhs, and not for a rebate as my income is above five lakhs.

Proportional tax:

- Irrespective of income or profit, the tax rate remains the same.
-

Regressive Tax:

- As the income or profit increases, tax rates decrease.
- Indirect taxes seem to be regressive, as the poor man ends up paying a higher proportion of his income as tax.



-
- **Excise Duty:** It is levied on production or manufacturing.

CASCADING EFFECT OF TAX (10:00 AM):

- Cascading tax effect is also termed "**tax on tax**".
- This effect occurs when a good is taxed at every stage of production.
- This means each succeeding transfer of goods is taxed inclusive of the taxes charged on the preceding transfer.

- This will increase the cost of the product for the final customer.
- The cascading effect is one aspect of **Tax inefficiency.**
- **Goods & Services Tax (GST)** is an example to reduce tax inefficiency.

For Example-

- Let us assume that the central government levied a 10% excise duty on the production of a mobile phone worth 20,000.
- Now the phone will cost rupees 20,000 + 2000(10% of 20,0000) = 22000.
- If the states levy a sales tax of 10% on the final price of the phone, the final price of the phone will become 22000 + 10% of 22000= 24200.
- If we observe, the 2000 rupees added after levying of excise duty by the central government, got taxed again by the state under sales tax.
- This is cascading of tax-tax on the tax amount already paid.
- Multiple taxing can be done by the center twice, states twice, or even by the center and the states.
- GST aims to reduce the tax on tax, which will also reduce the final price of the product.

INDIAN SITUATION IN THE 1960S & THE 1970S (10:30 AM):

- As India was following **import substitution,** large taxes were levied on imports.
- Direct taxes were at high rates, but due to tax inefficiency, tax collection was not very high.
- The purchasing power and income levels of the population were not very high, so tax revenues were low.
- The government had to take large debts to run welfare programs.
- These large borrowings caused large interest payments to be done in the future.
- This caused issues with **Intergenerational equity.**
- Any income of future generations will be reduced as a part of the income will go into payments of principal and interests of the loan taken.
- Such a situation was also seen after Covid.
- PSUs were(and most of them still are) not efficient in production, which means they produced materials at higher costs than was possible.
- As the final products were costlier, there was less demand for those goods in foreign and India.
- So the expected revenues of PSUs(government) were less than expected.
- Most PSUs used(and still use) outdated production strategies without **Research & Development (R & D)** for efficiency.
- The government had to continue vital imports like crude oil, food, etc.
- Costlier goods(imports and domestically produced) caused high inflation.
- Higher import bills caused a higher **trade deficit.**
- The situation was worsened by the global oil crisis of the 1970s.
- License Raj contributed to manufacturing companies working at sub-optimal levels.
- The agriculture sector was also not performing well because the Green Revolution was in its nascent stages.
- That era saw inflation because of **cost-push** factors.

Demand-Pull inflation:

- Too much money is chasing too few goods
- That means demand is driving inflation.

Cost-push Inflation:

- This inflation is mainly because of:
- I. An increase in raw-materials costs.
- II. Inefficient production techniques.
- III. High indirect tax rates, etc.

PROGRESSION OF INDIAN ECONOMY (11:10 AM):

- Indian economy of the 1960s and 1970s was mainly dependent upon the primary sector.
- The present Indian economy has the largest share of the service sector.
- All over the world, the major sector of the economy began from the primary sector, shifted to the manufacturing sector, and later to the services sector.
- Also, the labor force participation moves in that manner.
- But in India, the services sector became the largest contributor to the GDP after the primary sector.
- Due to the bureaucratic red tape of the license raj era, the manufacturing sector could never perform to its full capacity- neither in contribution to GDP nor in employment generation.
- The services sector(mainly Informational Technology) though contributes majorly to the GDP, but not everyone can participate in the sector.
- The services sector needs a much higher skill level that the primary or manufacturing sector, which most of India does not have.
- So we saw, and are seeing **Jobless Growth,** where the growth in GDP could not get reflected in the growth in employment.
- This was also due to less growth in the labor-intensive services sector like the tourism sector.
- The services sector all over the world and especially in India is facing treat from the developments in **Artificial Intelligence.**
- A large number of job profiles are expected to be redundant soon.

EMPLOYMENT (11:35 AM):

- **Labor Force:**
- People between the ages 15-64 who are already working (workforce) and those who are between 15-64 who are looking for work, but have no work.
- The unemployment rate is measured over the labor force.
- Unemployment rate= ((Labor force- Work force)/ Work force)* 100.

Disguised unemployment:

- It is a problem related to Indian agriculture where the marginal productivity of the labor is almost zero.
- **For example-** 10 people working on a farm and doing the work which can also be done with 5 people.

Underemployment:

- The situation where people are employed in jobs that demand fewer skills and qualifications than they have.
- **For example-** Postgraduates working in call centers.

Capital Intensive Growth model:

- The **Nehru-Mahalanobis Model** of the 2nd 5-year plan focussed on capital goods production.
- This failed to create the expected employment growth.

Hindu Rate of Growth:

- This refers to low rates of GDP growth (less than 3.5 %).
- India experienced this till the 1970s.

Jobless Growth:

- After 1991, India went out of the Hindu rate of growth but failed to create more jobs due to muted manufacturing growth.
- Due to this muted growth, problems of disguised employment and **Over-Tertiarization of the Indian Economy** were seen.

Gig Economy:

- This is the economy that is driven by freelancers who work without social security.
- **For example-** Zomato delivery boys, Ola drivers, etc.

-

Books for self-study (for interviews and essays):
75 Years of Indian Economy by Sanjay Baru.

Homo Deus by Yuval Noah Harari.

21 Lessons for the 21st Century by Yuval Noah Harari.

Mains Answer on inclusive growth/ jobless growth:

- The answer must have the following themes:
- I. Rising inequality.
- II. Failure of trickle-down theory.
- III. Causes & effects of jobless growth.
- IV. Progressive taxation.
- V. Financial Inclusion, instead of "opening bank accounts for everyone".
- VI. Investments in labor-intensive sectors.
- We will try to substantiate our points with relevant data.

The topic for the next class is Economic Growth.