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‘TAX CUTS MAY NOT BOOST INVESTMENT’

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Public Finance, Taxation & Black Money incl. Government Budgeting

While corporate India is cheering the cut in tax rates, announced by the government, economists are saying mere reduction in levies will not result in increased private sector investments and the move will definitely result in fiscal deficit slippage.

The overall view is that since the corporate tax cuts do not address the subdued demand conditions in the economy, private sector firms will wait for demand to revive before they start investing.

“Companies will still wait for demand to pick up,” said Madan Sabnavis, chief economist, Care Ratings. “The cuts have to encourage manufacturing companies, that have not been investing, to start investing.Only if demand actually increases, will the tax cut help in bringing about higher investment, not otherwise.”

“At the end of the day, if you don’t have the assurance that your output is going to be bought, then you are not going to make profit,” Pronab Sen, former Chief Statistician of India, added.

“A tax on profit kicks in only if you are making profit. It has already given a huge boost to so-called investor sentiment, but these are all secondary market reactions.”

However, there is also the view that corporate tax rate cuts will make Indian companies more competitive globally, and will encourage foreign companies to invest in India, which could boost private sector investments.

Corporate savings to rise

“It will increase corporate savings and therefore, also investment and make Indian firms more competitive,” said D.K. Srivastava, chief policy advisor, EY India.

“They will also encourage investment from abroad into Indian companies because we will be on par with comparable economies with regard to tax incidence.

The impact on the fiscal deficit, however, is under debate.

The combination of the Rs. 1.45 lakh crore revenue foregone due to the cuts announced on Friday, the fiscal impact of the various export and housing incentives announced recently and lower-than-budgeted GST revenue is expected to total anywhere between 0.5-1% of GDP.

“In the Budget as presented, they had taken account of Rs. 90,000 crore from the RBI,” Dr. Sen explained. “What they got was Rs. 1.76 lakh crore. So, the net gain was only Rs. 86,000 crore. The net loss here [due to the corporate tax rate cut] is Rs. 1.45 lakh crore, so there is still a Rs. 59,000 crore hole because the impact of these cuts was not budgeted.”

“Let’s assume GST collections come in according to plan,” Mr. Sabnavis said. “This corporate rate cut plus the incentives for exports and housing they announced will together come to 0.5% of GDP. The fiscal deficit will definitely go from 3.3% to 3.7-3.8%. That is the range we are looking at.”

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