The background of the entire page is a close-up photograph of a cotton field. The cotton bolls are white and fluffy, with some showing the green stems. A bright yellow diagonal stripe runs from the bottom left towards the top right. On the left side, there is a graphic element consisting of a series of vertical black lines of varying heights, resembling a barcode or a stylized 'E' shape.

Implications of Goods and Services Tax (GST)
for Indian Textiles Sector

Ministry of Textiles, Government of India

Report on
'Implications of Goods and Services Tax (GST) for
Indian Textiles Sector'



Contents

Executive Summary.....	viii
Chapter 1: Industry Features.....	1
1.1 Introduction	1
1.2 Key Features of the Textile Industry	2
1.2.1 Production.....	2
1.2.2 Consumption Expenditure	4
1.2.3 Exports.....	7
1.2.4 Utilization of Raw Materials	10
1.2.5 Prices	11
1.3 Summary	14
Chapter 2: Textile Value Chains.....	15
2.1 Value Chain: Overall Textile Sector	15
2.2 Cotton Textiles and Man-made Textiles.....	17
2.3 Woollen Textiles	19
2.4 Handlooms	19
2.5 Silk Textiles.....	21
2.6 Artificial Silk, Synthetic Fibre Textiles	22
2.7 Jute, Hemp, Mesta Textiles	22
2.8 Carpet Weaving	23
2.9 Readymade Garments and Made-up Textiles	24
2.10 Miscellaneous Textile Products.....	24
Chapter 3: Current Tax Structure.....	25
3.1 Central Excise Duty	25
3.2 Service tax.....	26
3.3 State Sales Tax/Value Added Tax	26
3.4 Tax on Inter-State Sales/Central Sales Tax	26
3.5 Entry Tax/Octroi/Local Body Tax.....	27
3.6 Inefficiencies in the Indirect Tax System.....	27
3.7 Domestic Indirect Taxes: Some Textile-specific Issues	30
Chapter 4: Emerging Contours of GST	35
4.1 Introduction	35
4.2 Design of GST: Basic Features	35

4.3	Main Features of the Revised Constitution Amendment Bill	36
4.4	Key Unsettled Aspects of GST	39
4.4.1	CGST and SGST Structure and Rates.....	39
4.4.2	Inter-State Transactions	40
4.4.3	Threshold Limits	40
4.4.4	Exempted Goods and Services.....	40
4.4.5	Treatment of Demerit Goods and Petroleum Products	40
4.5	GST and the Textile Sector: Some Specific Aspects.....	41
Chapter 5: Estimation of Revenue Neutral Rates.....		43
5.1	Introduction	43
5.2	Segment-wise Input Structure of Textile Products	44
5.3	Cenvat Revenue from Textile Sector.....	47
5.4	Revenues from State VAT and Related Tax Revenues from the Textile Sector.....	49
5.4.1	Additional Excise Duties on Textiles in lieu of Sales Tax.....	49
5.4.2	Potential Revenue from levy of VAT on textiles	52
5.5	Central and State Tax Rates	52
5.6	Estimation of Revenue Neutral Rates: Methodology	55
5.6.1	Estimation of Textile Inputs and Outputs.....	56
5.6.2	Estimation of Tax Base with Reference to the Present Tax System.....	56
5.6.3	Estimation of Revenue Neutral Rates: Textile Sector as a Whole.....	57
5.6.4	Segment-wise Revenue Neutral Rates.....	58
Chapter 6: Textile Industry: Prospects and Policy Support.....		60
6.1	Rebalancing Cotton and Manmade Fibres in Textile Product Mix.....	60
6.1.1	Cotton	60
6.1.2	Manmade Fibres.....	61
6.1.3	Jute and Silk.....	62
6.2	Modernization and Technology Up-gradation of the Textile Sector.....	63
6.3	Policy Support to Textiles.....	63
6.3.1	Central Government Initiatives.....	63
6.3.2	State Government Initiatives.....	65
6.3.3	Export Incentives.....	65
6.4	Perspective on WTO Restrictions.....	72
Chapter 7: Textile Industry: Implications of GST		77
7.1	Introduction	77

7.2	General Effects of GST	78
7.2.1	Selected International Experience	78
7.2.2	India-specific General Effects.....	80
7.3	Textile Specific Effects of GST	81
7.3.1	Rate-Revenue Augmentation Effect	81
7.3.2	Fibre-neutrality Effect	87
7.3.3	Transparency Effect	88
7.3.4	Export Zero Rating Effect	88
7.3.5	Common Market Effect	88
7.3.6	Investment Promoting Effect	88
7.3.7	Improved Compliance Effect.....	88
7.4	Policy Options for Textiles under GST	89
7.4.1	Policy Options and Specific Textile Segments.....	90
Chapter 8: Textile Industry: Preparing for Transition to GST.....		93
8.1	Transformation of Fibre-Mix	93
8.2	Input-Neutral Fiscal Regime.....	94
8.3	GST: Government and Industry Preparations.....	95
Chapter 9: Conclusions		98
9.1	Current Tax Scenario.....	98
9.2	Emerging Contours of GST.....	99
9.3	Estimation of Revenue Neutral Rates.....	101
9.4	Implications of GST for the Textile Industry	102
9.5	Prospects and Policy Support	104
9.6	Preparing for Transition to GST: Textile Industry	104

List of Tables

Table 1.1: Production of Spun yarn, Filament Yarn and Fabric	4
Table 1.2: Final Consumption Expenditure on Textiles (Clothing and Furnishing) in 2011-12	6
Table 1.3: India's Share in World Textile and Clothing Exports	7
Table 1.4: India's Textile & Clothing Exports to Selected Countries.....	8
Table 1.5: Share of Exports of Principal Commodities in Total Commodity Exports	9
Table 1.6: Share of World Exports of Textile and Clothing (in US\$)	10

Table 1.7: Growth rate of Textile Exports: CAGR of Exports in Rupee terms	10
Table 1.8: Consumption of Various Textile Raw Materials.....	11
Table 1.9: Prices of Various Textile Inputs	12
Table 4.1: GST Rate Structure	39
Table 5.1: Inputs to Textile Products: Relative Shares of Textile and non-Textile Inputs	44
Table 5.2: Textile Inputs for Textile Products: Relative Share of Inputs in Total Inputs	45
Table 5.3: Relative Share of Non-textile Inputs (Goods).....	46
Table 5.4: Relative Share of Non-textile Sector (Services).....	47
Table 5.5: Central Excise Collections	48
Table 5.6: Effective Cenvat Rates: Textile Inputs and Outputs.....	53
Table 5.7: VAT Rates: Textile Inputs (Goods and Outputs).....	54
Table 5.8: Revenue Neutral Rates: Textile Sector (Reference Year: 2011-12)	58
Table 5.9: Estimation of Revenue Neutral Rates.....	59
Table 6.1: Prospects of Production and Consumption of Cotton.....	60
Table 6.2: Future Outlook for MMF/filament Yarn Demand	61
Table 6.3: New Investment Requirement up to 2020: (For all sectors)	63
Table 6.4: Key Features of Major Central Government Schemes	63
Table 6.5: Key Features of State Government Textile Policies	65
Table 6.6: Status Holder Categorisation.....	69
Table 7.1: Demand for Clothing: Long Run Equilibrium Relationship.....	83
Table 7.2: Demand for Clothing: Short Run Dynamics: Error Correction Equation.....	84
Table 7.3: Price and Income Effects	85
Table 7.4: Pattern of expenditure on essential items in Rural India: Share of Monthly per capita expenditure.....	86
Table 7.5: Pattern of expenditure on essential items in Urban India: Share of Monthly per capita expenditure.....	87
Table 10.1: Lower and Higher VAT Rates Across Selected States: 2007-08 to 2012-13	121

List of Figures

Figure 1.1: Share of Final Consumption Expenditure on Textiles in Total Private Final Consumption Expenditure.....	5
Figure 1.2: Share of Textile Exports in Total Exports and Exports of Manufactured Products	9

Figure 1.3: Price Trends of various types of Cotton yarn (Rs/kg).....	13
Figure 1.4: Price Movement: Man-made Fibres and Wool (Rs./kg)	14
Figure 2.1: Textile Value Chain: Typical All-Segment Pattern	16
Figure 2.2: Value Chain: Cotton Textiles/ Manmade Fibre Textiles.....	17
Figure 2.3: Major stages in the value chain of Woollen Textiles.....	19
Figure 2.4: Value Chain: Handloom Sector	20
Figure 2.5: Value Chain: Silk Textiles	21
Figure 3.1: Structure of Indirect Taxes in India.....	27
Figure 3.2: Typical Tax Supply Chain in the Textile Industry	32
Figure 7.1: Productivity Improving Channels of GST	80
Figure 7.2: Growth in Demand for Clothing and Underlying Trend through HP Filter	82

List of Annexures

Annex 1: Customs Duty	106
Annex 2: Treatment of Input Tax Credit on Capital Goods.....	107
Annex 3: Calculation of the Share of Organised Sector	109
Annex 4: Calculation of Central and State Tax Rates.....	110
Annex 5: Calculation of Total Final Use	111
Annex 6: Details of Duty Drawback Schemes.....	113
Annex 7: Salient Features of Duty Credit Scrips.....	115
Annex 8: Jute Sector Value-Chain.....	117
Annex 9: Carpet Weaving Sector Value Chain.....	118
Annex 10: Changes in Cenvat and State Tax Rates.....	119
Annex 11: Constituents of Textile Segments in Input-Output Matrix	122
Annex 12: Terms of Reference.....	123

List of Abbreviations

AED – Additional Excise Duty

AIR - All Industry Rate

AP – Andhra Pradesh

ASCM - Agreement on Subsidies and Countervailing Measures

ASF – Acrylic Staple Fibre

BH – Bihar

CAGR – Compounded Annual Growth Rate

CGST – Central Goods and Services tax

CSO – Central Statistical Organisation
CST – Central Sales tax
CVD – Countervailing duty
DGFT – Directorate General of Foreign Trade
EC – Empowered Committee
ECGC – Export Credit Guarantee Corporation
EH – Export House
EHTP - Electronic Hardware Technology Park
EOU – Export-Oriented Undertakings
EPCG – Export Promotion Capital Goods Scheme
EPZ – Export Promotion Zone
EU – European Union
FMS – Focus Market Scheme
FOB – Free on Board
FPS – Focus Product Scheme
GFCE - Government Final Consumption Expenditure
GFCF - Gross Fixed Capital Formation
GJ - Gujarat
GoG – Government of Gujarat
GSDP – Gross State Domestic Product
GST – Goods and Services Tax
GSTN – GST Network
GVA – Gross value added
HACCP - Hazard Analysis Critical Control Point
IGST - Integrated Goods and Services tax
IMSC – Inter Ministerial Steering Committee
I-O Matrix – Input-Output Matrix
ISDS - Integrated Skill Development Scheme
ITC – Input tax credit
KVIB - Khadi & Village Industries Board
KVIC – Khadi and Village Industries Commission
LC – Line of credit
MAI - Market Access Initiative
MDA - Market Development Assistance
MH - Maharashtra
MLFPS – Market Linked Focus Product Scheme
MMF – Man-made fibre
NAS – National Accounts Statistics

NCCD – National Calamity Contingent Fund
NSSO – National Sample Survey Organisation
PFCE - Private Final Consumption Expenditure
PB - Punjab
PLA – Personal Ledger Account
PPFY – Polypropylene Filament Yarn
PPSF – Polypropylene Staple Fibre
PSF – Polyester Staple Fibre
PSY – Polyester Filament Yarn
RNR – Revenue Neutral Rate
SAD – Special Additional duty
SEZ – Special Economic Zones
SGST - State Goods and Services tax
SGSY - Swarnjayanti Gram Swarozgar Yojana
SHIS – Status Holder Incentive Scheme
SITP - Scheme for Integrated Textile Parks
STP – Software Technology Park
TAMC - Technical Advisory-cum-Monitoring Committee
TFUSE – Total Final Use
TMTT - Technology Mission on Technical Textiles
TUFS – Technology Upgradation Fund Scheme
UP – Uttar Pradesh
VAT – Value-added tax
VKGUY - Vishesh Krishi and Gram Udyog Yojana
VSF – Viscose Staple Fibre
VSY - Viscose Filament Yarn
WB – West Bengal
WHOGMP - World Health Organization-Good Manufacturing Practices
WTO – World Trade Organisation

Executive Summary

Introduction

1. Goods and Services tax (GST) constitutes the last mile of a long journey of reforms of indirect taxes in India. GST will replace a number of central and state taxes. The important taxes that may be subsumed in GST are central excise and service tax at the central level and state VAT/sales tax, central sales tax, and entry tax at the state level along with a number of additional or special duties and cesses and surcharges. The final design of the GST and the related constitutional amendment are yet to be finalized. However, the impact of GST on the textile sector will be quite significant.
2. Taxation of textile sector is opaque and non-neutral across its various segments. Many textile outputs are either exempt under the central and state tax regimes or are subjected to relatively low tax rates. Most of the indirect taxes fall on inputs, both goods and services, and therefore remain hidden. On the whole, the textile sector is lightly taxed and extensively subsidized. Textile exports are supported through payments of un-rebated taxes (duty drawback) on textile inputs and other subsidies.
3. This study examines the implications of GST for the textile industry. It estimates the revenue neutral rates for the relevant textile segments under the GST and highlights the implications of GST for the growth, employment and export potential of the industry. It also highlights changes required in the subsidy and support policies of the government as and when the GST regime replaces the current regime of indirect taxes.

Industry Features

4. The textile industry is characterized by large inter-state movements both in respect of inputs and finished products. It also draws inputs from many other sectors consisting of both goods and services including dyes and chemicals, petroleum products and transport services. There is a large inter-face between organized and unorganized sectors. Given the inter-state and inter-industry movement of goods and services and interdependence of organized and unorganized sectors in the textile industry, the GST will have significant effects on the growth and productivity of the textile sector.
5. In the global exports of textiles, India is ranked as the third largest exporter, trailing EU-27 and China. Many countries including the US are putting pressure on India to withdraw subsidies or support to the textile sector. This is because as per the WTO rules it has crossed the export competitiveness threshold, defined as achieving 4% of world trade in the sector. Under GST, some of the existing subsidization would be taken care of automatically. Policy support will have to be redesigned.

6. At present the fibre mix in India is 59:41 in favor of cotton vis-à-vis man-made fibres. Internationally, it is the other way round. A fibre-neutral GST regime would encourage the use of man-made fibres. This will support the growth of the overall textile sector and its export competitiveness.

Current Domestic Indirect Tax Structure

7. The main central indirect taxes are central excise duties or cenvat and service tax. Since textiles are goods, the relevance of service tax is only with respect to service inputs into textile outputs. The main state taxes are sales tax/State VAT, tax on inter-state sales (also called the central sales tax) and entry tax. These pertain to textiles outputs as well as non-service textile inputs.
8. In spite of reforms, the current domestic indirect tax regime suffers from various inefficiencies. Taxation of inputs and capital goods creates a huge cascading impact on the industries. High and multiple tax rates coupled with exemptions and concessions further add to the complexities. Also, taxation of inter-State sales and lack of harmony in the states' sales tax systems, which now prevails in the state VAT system, encourages harmful inter-state competition and leads to market distortions.
9. At the State VAT level, numerous complexities exist, primarily relating to classification of goods in different tax rate schedules. For instance, the basic necessities could be exempted from tax, taxable at 4-5%, or taxable at the standard rate of 12.5% or higher. Another source of complexity under the State VAT is determining whether a particular transaction constitutes a sale of goods or of services.

Emerging Contours of GST

10. Many of these problems can be addressed by extending the scope of taxation of services for the states and the scope of taxation of goods up to the retail stage for the centre. Considerable discussion has already taken place as to a suitable design and administrative framework for GST. While, it has not been possible to resolve all the differences, significant progress has been made and the main contours of the GST appear to be emerging.
11. Taking account of the latest developments, the present position is that the central government has come out with a revised draft of the constitution amendment bill (2013) after receiving the report of the Parliamentary Standing Committee on the earlier constitution amendment bill (2011). The revised constitution amendment bill is presently being deliberated upon by the Empowered Committee (EC) of the State Finance Ministers. Based on the discussions at the Empowered Committee and the deliberations of the central government, certain contours of the GST have emerged clearly while there are some critical aspects on which decisions will have to be taken by the proposed GST Council.
12. GST will be a concurrent GST where the central and State governments will share a common tax base consisting of the value added of goods and services in the production and sale of goods and services.

- ▶ The GST will have two components: one levied by the Centre (CGST) and the other to be levied by the States (SGST). The basic features of law such as chargeability, definition of taxable event and taxable person, measure of levy including valuation provisions, basis of classification etc. should be uniform across these statutes as far as practicable.
 - ▶ The CGST and SGST would be applicable to all supply of goods and services made for a consideration except for the exempted goods and services, goods which are outside the purview of GST and the transactions which are below the prescribed threshold limits.
 - ▶ The CGST and SGST are to be paid to the accounts of the Centre and the States separately. Taxes paid against the CGST and SGST will get input tax credit (ITC) within the CGST and SGST chains respectively but cross utilization of credits between CGST and SGST would not be allowed.
 - ▶ The administration of the CGST will be with the centre and that of SGST with the states. Both will be supported by a common portal (managed by the GSTN, a special purpose entity already incorporated) for the front-end compliance functions of registration, return filing and processing, and tax payments and refunds.
 - ▶ The following Central Taxes are to be subsumed under the GST: (i) Central Excise Duty, (ii) Additional Excise Duties, (iii) Excise Duty levied under the Medicinal and Toiletries Preparation Act, (iv) Service Tax, (v) Additional Customs Duty, commonly known as Countervailing Duty (CVD), (vi) Special Additional Duty of Customs (SAD), (vii) Surcharges, and (viii) Cesses.
 - ▶ The following State taxes and levies should be, to begin with, subsumed under GST: (i) VAT / sales tax, (ii) entertainment tax (unless it is levied by the local bodies, (iii) luxury tax, (iv) taxes on lottery, betting and gambling, (v) State cesses and surcharges in so far as they relate to supply of goods and services, and (vi) entry tax not in lieu of Octroi.
13. Petroleum products such as crude, motor spirit (including ATF) and HSD would be kept outside GST. Sales Tax could continue to be levied by the States on these products with a floor rate. Similarly, Centre could also continue its levies. Alternatively, petroleum products may also be included in the scope of GST with the provision of a non-rebatable excise/sales tax over and above the standard rate of GST.
14. In this model, the Centre would levy an Integrated Goods and Services Tax (IGST) which would be CGST plus SGST on all inter-state transactions of taxable goods and services with appropriate provision for consignment or stock transfer of goods and services. Present discussions indicate that IGST or an equivalent mechanism will be developed and the current sales tax on inter-state sales which is levied in the origin state (central sales tax) will be abolished.

Estimation of Revenue Neutral Rates

15. Revenue neutral rates may be calculated for the central government and state governments, separately and jointly. In this exercise, the effort is to find out the GST rate, composed of the CGST and SGST rates, which would raise the same amount of revenue as is presently being raised under the taxes that are to be merged into the GST.

16. State governments have not levied VAT on textile outputs in general after the arrangement under additional excise duty in lieu of sales tax was discontinued. These sectors continue to be exempt. But if any input taxes are paid, these may be blocked and should be taken into account in calculating the RNR. Furthermore, a major difficulty is that the state governments do not compile data according to industries or products. As such there is no data with respect to State VAT, central sales tax, or entry tax paid on textile products with respect to which the RNR can be calculated.
17. Given the importance of blocked input taxes, the input-output table, the latest version of which relates to 2007-08, is an important component of the methodology used here. The textile sector is decomposed into nine segments in the table. These nine segments are indicated below:
 - ▶ Khadi and handlooms
 - ▶ Cotton textiles
 - ▶ Woollen textiles
 - ▶ Silk textiles
 - ▶ Art silk and synthetic fibre textiles
 - ▶ Jute, hemp, and mesta textiles
 - ▶ Carpet weaving
 - ▶ Ready-made garments
 - ▶ Miscellaneous textile products
18. The RNR calculations are done with reference to 2011-12 data for each of these nine segments.
19. If we look only at the RNR with respect to output taxes paid by the textile dealers, it is very low. An appropriate comparison would be between potential tax revenue attributable to the textile sector that includes output tax and blocked input taxes applied on an estimated base under the present tax system and the potential revenue under GST estimated by applying a GST rate on an estimated base for GST. In this comparison, the RNR comes out to be 9.3%. The RNR for the central taxes is 4.4% and that for state taxes is 4.8%. This is still much lower than 12%, which might be the lowest rate (6% CGST and 6% SGST) in the GST regime with two tax rates (a lower rate for necessities, and a standard rate). We conclude, therefore, that for the textile sector considered as a whole the movement to GST will lead to additional tax burden. If the GST rate is fixed at 12%, effectively the tax rate will increase by a little less than three percentage points.
20. RNRs are highest for the segment of miscellaneous textile products (12.0%) and the readymade garments segments (10.5%) and relatively lower for the handloom, carpet weaving and cotton textile sectors.
21. In deciding a suitable form of GST for textiles, issues as to whether some segments can be exempted or whether selective concessions may be given often arise. It may be remembered that any exemptions or selective concessions would block input taxes, which will remain hidden as at present. What can be unambiguously argued is that if there is one single GST rate (CGST+SGST), it would suit the textile industry that this rate is kept as low as possible. If there is a dual rate structure, textiles should be placed at the lower rate.

Implications of GST for the Textile Industry

22. The main implications of GST compared to the present domestic indirect tax regime in the context of Textiles can be divided into two parts: (a) main and immediate effect, which may be adverse in nature and (b) other longer term positive effects.

Main Effect: Rate-Revenue Effect

- ▶ Since the CGST and SGST rates are likely to be higher than the corresponding textile sector RNRs; the textile prices would go up. This will adversely affect demand for textile products. Our estimates based on time series on private final consumption expenditure on clothing shows that demand elasticity with respect to implicit price deflator of clothing relative to implicit price deflator of all goods is low (about 0.3). Therefore the magnitude of effect will be low. This will be further mitigated because estimates indicate that GST will have an overall positive income effect. Demand for clothing is also income elastic and the magnitude of estimated income-elasticity is somewhat higher at 0.5. Furthermore, since the demand elasticity is less than one, the fall in quantity demanded will be less than the increase in prices due to the rate increase resulting in higher revenues.
- ▶ We estimate that for the textile sector as a whole the adverse effect of a price rise on demand will be just neutralized by a positive income effect if the GST rate applicable to all textile segments is 12%. But demand in the case of three textile segments, namely Khadi and Handloom, Cotton Textiles and Carpets would be adversely affected while there will be a net positive effect on the other sectors. This will lead to substitution effects within the textile sector encouraging greater use of man-made fibre based textiles and blends that use relatively more of synthetic fibres.
- ▶ We also note that the estimates were made with respect to 2011-12 centvat and statevat rates, which were raised subsequently. The centvat rate was raised by 2% points. The statevat rates both at the lower end and higher end were also raised by many states. Thus the overall RNR at the present rates will be higher than 12%, possibly closer to 14%.

Other Positive Effects

Some of the longer term positive effect would be as follows.

- ▶ GST is likely to have a fibre-neutral rate structure unless differentiation is introduced by explicit choice (Fibre Neutrality Effect);
- ▶ Textile outputs will be taxed if domestically consumed and input taxes paid will be rebated making the tax-regime transparent (Transparency Effect);
- ▶ Exports will be zero-rated and all input taxes paid will be rebated by the tax authorities making duty drawback kind of schemes redundant (Export Zero-rating Effect);
- ▶ Fiscal barriers to inter-state movement of textile inputs and outputs like the CST and the entry tax will be eliminated (Common Market Effect);
- ▶ Taxes on capital and machinery will be fully rebated (Investment Promoting Effect); and
- ▶ For the industry, compliance costs will be lower (Compliance Promoting Effect).

23. All effects other than the first will have a positive impact on the industry. The first effect, namely the increase in tax revenues through a hike of tax rates under GST, will have an adverse impact as it would lead to a price increase. This arises partly because State governments have not been able to levy a sales tax on textiles after the withdrawal of the arrangement under additional excise duty in lieu of sales tax. However, given that part of the textile products constitute goods of mass consumption, this adverse effect will have to be neutralized partly through the higher productivity linked to GST (through better resource allocation and infusion of new technology) and partly through adequate policy recasting using the additional revenues that the central and state government may earn.
24. GST rates cannot be commodity-specific. We consider that the overall GST rate would be nearly 3 percentage points higher than the combined RNR for the textile sector considered as a whole. This will yield additional revenues both to the central government and the state governments from the textile sector, even though the GST as a whole may be revenue neutral.
25. Segment wise effects will be different depending on the specific RNRs. Given the segment-wise textile specific RNRs and the GST rates, those textile sectors where the RNR is lower than the GST rates, there will be an additional tax burden. For those textile segments, where the RNR is more than the GST rate, there will be a lower tax incidence compared to the present situation. Except for two segments, namely silk textiles and artificial silk and synthetic fibre textiles, all other segments have a low effective rate of tax and in all probability GST rates will be higher than the segment specific RNRs.
26. Under GST, exports will be fully and automatically zero-rated. This will cover all domestic taxation of inputs used for products that are exported. This will reduce the scope of duty drawback scheme considerably as all input taxes paid in regard to domestic indirect taxes, namely, central excise duties, service tax, state sales tax, inter-state sales tax, and entry tax will be rebated. The money that will be released from duty drawback scheme could then be used for supporting the sector.
27. With the abolition of the inter-state sales tax (central sales tax) and entry tax, the Indian market will become a genuine all-India market without fiscal barriers. Textile industry, where considerable movement of both inputs and outputs takes place, will be one of the main beneficiaries.
28. With taxes paid on purchases of machinery and equipment also being fully rebated, investors will be induced to modernize textile production by induction of modern machinery and equipment. This may be further facilitated by redesigning the Technology Upgradation for Textiles (TUFS) scheme.
29. An important effect of GST would be to improve compliance. The value chain under the GST will be fully traceable. As a result, ITC claims will have to be backed by full information chain of purchases and sales. Improved compliance will automatically lead to higher revenues for any given rate as long as that rate is not excessively high. Subject to certain qualifications, we have estimated compliance gap in the textile sector to be in the range of 30-35 percent. The governments have already endorsed the creation of the GSTN, which would

provide a common portal for the front-end compliance functions of registration, return filing and processing, and tax payments and refunds for both CGST and SGST. This common portal should result in a significant reduction in compliance costs, and also more effective monitoring of under/over reporting of sales and purchases.

30. The final GST rates have not been decided yet. It may be said that if a dual GST rate structure is adopted, it would be beneficial for all the textile segments to be placed at the lower rate. This should enable all input taxes to be fully rebated. In general, exemptions should be avoided since these will imply blockage of input taxes. The industry should also plead for avoiding the higher rate in a dual rate GST structure for any of its segments since that will adversely affect prices and demand.

Prospects and Policy Support

31. Cotton consumption has witnessed a sustained increase since 2003-04 due to the growing demand for Indian cotton textiles and subsequently, there has been considerable expansion and modernisation of the textile mills. Even though the Indian cotton consumption has increased at a rapid pace in the last few years, it has not kept pace with the growth in domestic cotton production, which has led to a surplus of production since 2003-2004. As a result, India has emerged as one of the top exporters of raw cotton in the world. Currently, India is the second-largest exporter of cotton after the US.
32. India is also the second largest producer of man-made fibres (MMF) also. However, India's share in global exports of value-added textiles of manmade fibres is miniscule at around 2.25% in 2008 (India's MMF exports were US\$ 3.3 billion as against global exports of US\$ 146.7 billion). Hence, the domestic MMF to cotton fibre consumption ratio in India is 41:59 (FY09) while it is the reverse globally. The share of man-made fibres in total fibre consumption has risen from 25% in the early nineties to 41% at present. However, since the quota abolition, the share of MMF in India's fibre consumption has almost stagnated at around 40% on account of rising cotton production and international demand for cotton by textile manufacturers to cater to export demand from global markets.
33. India has a number of schemes for rebating or subsidizing textile exporters. These include duty drawback schemes, which aim at promoting exports by seeking to rebate duty or tax chargeable on any imported/excisable goods and input services used in the manufacture of export goods. The duties and tax neutralized under the scheme are (i) Customs and Union Excise Duties in respect of inputs and (ii) Service Tax in respect of input services. The Duty Drawback is of two types: (i) All Industry Rate and (ii) Brand Rate.
34. There are also duty credit scrips. Under these schemes specified products and specified sectors are incentivised by way of Duty Credit Scrips ranging from 2% to 5%. The Duty Credit may be used for import of inputs or goods including capital goods, provided the same are freely importable under ITC (HS) which provide the rules and guidelines related to import policies. Additional customs duty/excise duty paid in cash or through debit under this scrip is adjusted as CENVAT Credit or Duty Drawback.

35. Increasingly, most of these schemes are falling on the wrong side of WTO restrictions. Apart from Duty Drawback and Export Oriented Units most of the other schemes do not conform to the Agreement on Subsidies and Countervailing Measures and can be potentially countervailed against, if not already done. Under GST, zero-rating of exports would imply that most of these schemes would not even be necessary.

Preparing for Transition to GST: Textile Industry

36. The textile industry in India is undergoing a major transformation in terms of product development and technological up-gradation. There is also increased competition to Indian exports from other major textile producers in the world; at the same time domestic producers have to compete with world supplies.

37. The global fibre consumption trend in future is likely to further tilt in favour of man-made fibres as there is a limitation to growth of cotton worldwide on account of limited availability of land for cotton cultivation. Huge additional capacities are required in the man-made fibre industry in the wake of future demand. However, the MMF industry is capital intensive with a long gestation period. Thus, it is desired that incentives are provided to the industry to accelerate the process of capacity build-up, to ensure adequate supply of fibres to the user industry.

38. At present, TUFS is not applicable to manufacture of synthetic fibres as the sector falls under the ambit of Department of Chemicals and Petrochemicals. If TUFS is available to manufacturers of synthetic fibres as well, it would aid in reducing the capital cost and hence the capital servicing charges such as depreciation and interest on debt taken for capital equipment purchase. Thus industry players want allocation of funds under TUFS for synthetic fibre manufacturing.

39. Overtime, India would be asked to roll back policies that are designed to benefit specific sectors or products. Most policy support will have to be designed in a manner such that benefits are common to all manufacturing segments or sectors and not specific to particular products. Schemes like TUFS and Product Focus Schemes will have to be redesigned such that the benefits are available in a more common way.

40. Thus, both the taxation regimes and subsidy regimes will progressively become product neutral and input-neutral. These changes will automatically lead to input and technology choices that aim to maximize efficiency rather than take advantage of fiscal benefits. Thus, the input-neutrality of tax and subsidy regimes will be particularly beneficial to the textile industry given the need to move to a fibre-neutral export oriented future.

41. Both the government (textile ministry and state textile departments) and textile industry should prepare for the transition to GST. Adequate preparation for the implementation of GST, not only by the central and state governments, but also by the industry, that is producers, wholesalers and retailers is a prerequisite for the success of GST in India. Dealing with the input tax rebate system in central excise, service tax, and sales tax has prepared the ground somewhat but much needs to be done when input tax rebate chain has to run full circuit in CGST

chain, SGST chain, and IGST. There are three key aspects of this preparation: (a) dealer registration; (b) establishing the input tax rebate chain in CGST and SGST separately, and (c) division of IGST revenue across states from the centre. For this purpose the information compilation and processing methodology and rules for determining origin and destination in the case of goods and more importantly services are going to be important.

Policy Options for GST

42. We have noted that the three segments that would be in a relatively disadvantageous position are: Khadi and Handlooms, Cotton textiles, and carpet weaving. The main policy options, which may be considered for specific segments or all segments of textiles are as follows:

- ▶ Zero rating
- ▶ Exemption
- ▶ Lower rate of tax
- ▶ Standard rate of tax with appropriate subsidies

43. Zero rating involves an effective mechanism for refunds and even advanced tax jurisdictions find it difficult to implement it. It should be recognized that zero rating will not cover producers with turnover below registration threshold levels. On the other hand, it may lead to rush for registration with the central and state governments to claim the refunds. It may also open up an avenue for claims that may be fraudulent.

44. The second option is exemption for selected segments. Exemption does not mean no incidence of tax since it results in blocked input taxes. The tax impact of exemption becomes dependent on the nature of supply chain. For example, vertical integration may reduce the magnitude of blocked input taxes. Exemption shifts tax burden from consumption to production. Exemption to fabrics leads to pressure from industry for exemption from production inputs as well. This leads to complexities in the administration of tax. In general, selective exemptions detract from the supply chain neutrality as well as fibre neutrality in the textile sector.

45. A desirable option is to subject the textile segments to the lower rate of tax, which may be possible in a dual rate regime or a low single rate. A GST regime with a single rate results in a clean tax system. It achieves production efficiency, which is the key concern as opposed to the regressivity of the tax system. It can be accompanied by an appropriate subsidy regime to support weakest segments of the textile industry. In the case of textiles, additional resources will be released to finance such subsidies as many of the existing support schemes will not be required once zero-rating of exports becomes integral to the tax system as under GST. A final view as to the relevant policy option can be taken once the design and rate structure of GST is decided.

Chapter 1: Industry Features

1.1 Introduction

Taxation of textile sector is opaque and non-neutral across its various segments. Many textile outputs are either exempt under the central and state tax regimes or are subjected to relatively low tax rates. Most of the indirect taxes fall on inputs, both goods and services, and therefore remain hidden, if un-rebated. On the whole, the textile sector is lightly taxed and extensively subsidized. Textile exports are supported through payments of un-rebated taxes on textile inputs and other subsidies. Textile units have historically enjoyed exemptions given to small industries.

The textile industry consists of a large number of small enterprises and a small number of large enterprises where the organized and unorganized sectors integrally coexist. The share of the decentralized sector has been increasing in recent years as compared to the mill sector.

Taxation of the textile sector will be significantly recast with the implementation of the Goods and Services tax (GST). The GST is expected to replace a number of existing central and state taxes. The important taxes that may be subsumed in GST are:

- ▶ Central taxes: Central excise duty, Service tax, Additional Customs duty, Special Additional Duty, surcharges and cesses
- ▶ State taxes: Sales tax/VAT, Central Sales Tax, Purchase tax, Entry tax, and state cesses and surcharges

The final design of the GST and the related constitutional amendments are yet to be finalized. The impact of GST on the textile sector will be quite significant but it will differ according to the design of the GST and the GST rates.

This study examines the implications of GST for the textile industry. It estimates the revenue neutral rates for the relevant textile segments under the GST and highlights the implications of GST for the growth, employment and export potential of the industry. It also highlights changes required in the subsidy and support policies of the government as and when the GST regime replaces the current regime of indirect taxes. The terms of reference under which the study was commissioned have been listed in Annex 12.

The textile industry is characterized by large inter-state movements both in respect of inputs and finished products. It also draws inputs from many other sectors consisting of both goods and services including dyes and chemicals, petroleum products and transport services. There is a large inter-face between organized and unorganized sectors. Given the inter-state and inter-industry movement of goods and services and interdependence of organized and unorganized sectors in the textile industry, the GST will have significant effects on the growth and productivity of the textile sector.

With the introduction of GST, several important questions arise. The rates at which the GST will be levied, consisting of the CGST, SGST and IGST rates, are likely to be different from the 'revenue neutral rates' with respect to the CENVAT rate and Service

tax rate and State VAT rates along with the additional and special excise duties and cesses and surcharges. Some of the important issues that need to be analysed are indicated below:

- ▶ Will this impose an extra burden on the textile sector?
- ▶ How will the tax expenditures with respect to the textile sector and other subsidy schemes of the central government and state governments be affected?
- ▶ How can these be redesigned?
- ▶ Under GST since the input tax credit chain will be completed, to what extent will it benefit the industry?
- ▶ Will *ceteris paribus*, employment, output and productivity in the textile sector improve as a result of GST?
- ▶ What are the channels through which the benefits will accrue to the industry?
- ▶ How should the industry itself get ready for the GST?

1.2 Key Features of the Textile Industry

The growth of the Indian textiles and apparel industry is linked to the overall growth of the Indian and the world economy. Demand for finished textile products majorly depends on population, purchasing power of the consumer and fashion trend. But as a part of the manufacturing sector, it also contributes to the overall GDP growth.

The Indian textile industry is amongst the very few in the world that is truly vertically integrated from raw material to finished products (from fibre to retail). The industry has leveraged its strong manufacturing position to improve its export performance. India is one of the largest exporters of readymade garments and made-ups to the world. India is considered as the second most preferred sourcing destination for major global retailers because of the availability of all types of raw material, availability of manpower at economic rate, vertical & horizontal integration of the industry, flexibility of the manufacturing process, capability of catering to smaller lot size etc.

In the last few years, the industry has witnessed considerable expansion, integration and technological up-gradation due to potential growth opportunities in the export as well as the domestic market. In this chapter, we look at key features and trends relating to four aspects of the textile industry: production, consumption, exports, and prices.

1.2.1 Production

The production cycle of the textile industry starts from raw materials such as cotton, jute, wool, silk, and in the case of synthetic textiles from specific petroleum products. Natural fibres like cotton, jute, wool, silk are spun into yarn while man-made staple fibres and filament are processed from petroleum products. While man-made staple fibres are spun into yarn, man-made filaments forming a continuous thread are directly used as yarn. These yarns are then either woven or knitted into fabric which is finally converted into apparel and home textile products. Technical textile products can be manufactured from fiber, yarn or fabric stage.

India is the second largest producer of fibre in the world and the major fibre produced is cotton. Other fibres produced in India include silk, jute, wool and man-made fibres. About 60% of the Indian textile Industry is cotton based.

Table 1.1 gives details of the production of yarn and fabric over the past few years. Yarn can either be spun yarn or filament yarn. Yarn produced from staple fibre is called spun yarn while filament yarn is in the form of a continuous thread. India is very competitive in the spinning sector. Cotton yarn is dominant amongst various types of spun yarn while polyester yarn is dominant amongst all filament yarns produced in India.

Major filament yarns produced in India are: viscose, polyester, nylon and polypropylene. Viscose is used to make viscose filament or rayon, which is commonly used in dresses, linings, shirts, shorts, coats, jackets, and other outer wear. It is also used in industrial yarns, upholstery and carpets. Polyester is one of the most important filament yarns produced in India comprising 94% of the total filament yarn production in terms of quantity during the six year period 2007-13. It is used in making apparel and home furnishings besides other industrial uses. Polypropylene is a major polymer used in nonwovens. Most of it is used for diapers or sanitary products where it is treated to absorb water. Nylon is widely used in the manufacture of carpets apart from being used as industrial yarn in manufacturing of tyre cord.

Fabric produced in India can also be divided into certain categories according to the type of yarn used: cotton, blended, 'Khadi, wool and silk' and 100% non-cotton. In terms of quantity, fabric production in India increased from 56.0 billion square meters in 2007-08 to 60.5 billion square meters in 2011-12 at a CAGR of 1.92%. Per capita availability of fabric has been on a rising trend with the growth rate of fabric production being greater than the growth rate of population in India. Table 1.1 gives the details.

Table 1.1: Production of Spun yarn, Filament Yarn and Fabric

Sl. No.	Items	Units	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13 (P)	CAGR (08-13)
1	Production of Spun Yarn								
(i)	Cotton	Mn. Kg.	2,948	2,896	3,079	3,490	3,126	3,583	3.98%
(ii)	Blended	Mn. Kg.	677	655	707	796	789	828	4.11%
(ii)	100% non-cotton.	Mn. Kg	378	361	407	427	457	457	3.87%
	Total	Mn. Kg	4,003	3,912	4,193	4,713	4,372	4,868	3.99%
2	Production of Filament Yarn								
(i)	Viscose filament yarn.	Mn. Kg	51	42	43	41	42	43	-3.35%
(ii)	Nylon filament yarn	Mn. Kg	28	28	30	34	28	23	-3.86%
(iii)	Polyester filament yarn	Mn. Kg	1,420	1,332	1,435	1,462	1,380	1,288	-1.93%
(iv)	Polypropylene yarn	Mn. Kg	11	15	15	13	13	17	9.1%
	Total	Mn. Kg	1,510	1,417	1,523	1,550	1,463	1,371	-1.91%
3	Production of Fabric								CAGR (07-12)
(i)	Cotton	Mn Sq. Mtr	27,196	26,898	28,914	31,718	30,570		2.97%
(ii)	Blended	Mn Sq. Mtr	6,888	6,766	7,767	8,278	8,468		5.30%
(iii)	100% non-cotton (exclude. Khadi, wool and silk)	Mn Sq. Mtr	21,173	20,534	22,840	21,765	20,567		-0.72%
(iv)	Khadi, wool & silk	Mn Sq. Mtr	768	768	812	798	848		2.51%
	Total	Mn Sq. Mtr	56,025	54,966	60,333	62,559	60,453		1.92%
4	Per Capita Availability of Fabric	Sq. Mtr	42	39	43	44	40		-0.84%

Source: Office of Textile Commissioner, Ministry of Textiles, Report on Textiles and Jute by the Working Group on the 12th Plan

1.2.2 Consumption Expenditure

We look at the pattern of consumption expenditure on textiles over time and across states. The former is based on the National Income Accounts data and the latter has been estimated using data from the National Sample Survey Organisation. The final consumption expenditure on textiles in India was Rs. 3,49,647 crore in the year 2011-12. As indicated in Figure 1.1 the share of private final consumption expenditure on clothing and furnishing in the total private final consumption expenditure has been falling over time. At its peak, this share was about 32 percent in the mid-fifties. By 2011-12, this share has fallen to about 17 percent. It appears to be stabilizing around this level. This is still a large part of the tax base for GST.

Figure 1.1: Share of Final Consumption Expenditure on Textiles in Total Private Final Consumption Expenditure

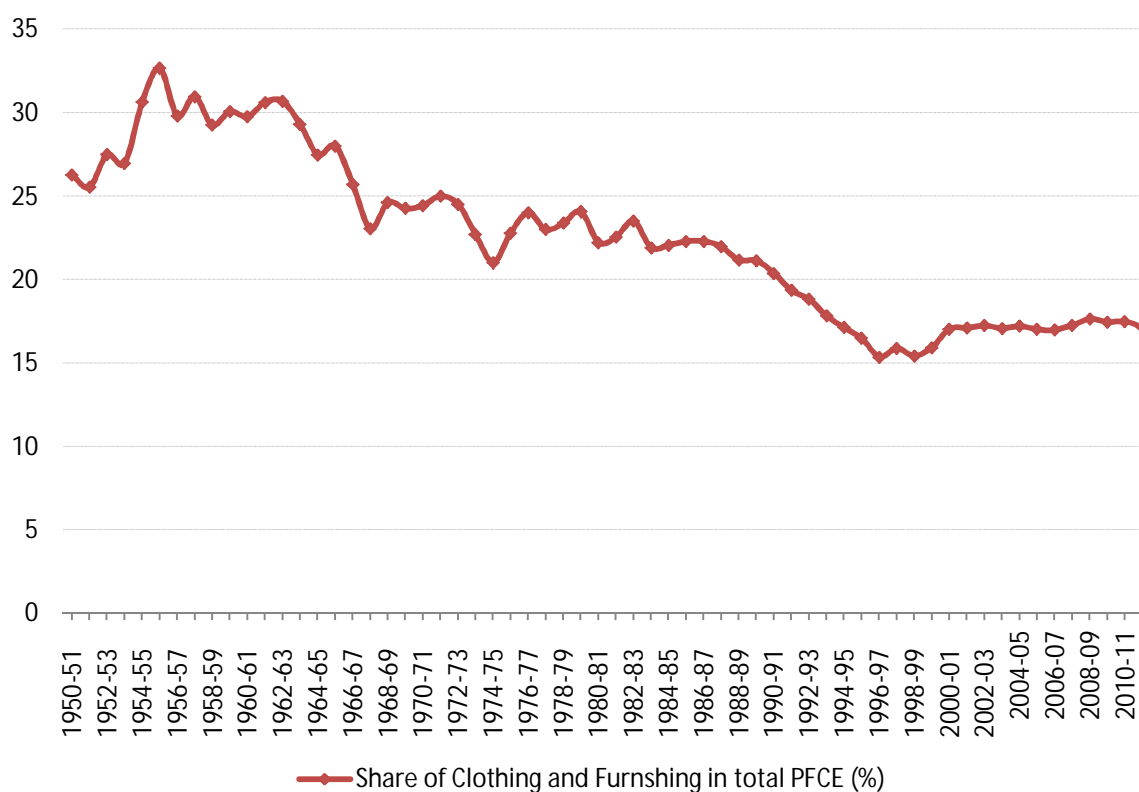


Table 1.2 gives the state-wise shares in consumption expenditure in 2011-12. The 2011-12 national final consumption expenditure value of textiles including clothing and furnishing have been derived by using national consumption expenditure data given in the National Accounts Statistics (NAS) 2011-12 and data from the Household Consumption Expenditure Survey conducted by the National Sample Survey Organisation (NSSO) in 2011-12. While the national figure for clothing is separately available from NAS, consumption of furnishing is included in the broad category 'Furniture and Furnishing'. To estimate the figure of furnishing, the ratio of consumption of furnishings to consumption of 'furniture and furnishing' was first calculated using the NSSO data and then multiplied with the relevant NAS category. Final consumption expenditure data from NAS on both furnishing and clothing were added to obtain the total consumption expenditure on textiles. Furnishing was found to constitute 4.4% of the total final consumption expenditure on textiles. State-wise shares of consumption of textiles were estimated from the NSSO data. The consumption figure from NAS was multiplied by these to obtain the state-wise distribution of textile consumption.

The final consumption expenditure on textiles in India was Rs. 3,49,647 crore in the year 2011-12. State-wise figures for consumption give a clearer picture of distribution. Figures show that the top five states in terms of textile consumption – Uttar Pradesh, Maharashtra, Andhra Pradesh, West Bengal and Bihar – accounting for nearly half (approx. 47.4%) of the total national consumption expenditure on textiles also account for 49.1% of the national population. The two major factors that seem to influence consumption of textiles are population and per capita GSDP. States with a higher population and per capita GSDP are expected to have a correspondingly greater demand for textiles.

Table 1.2: Final Consumption Expenditure on Textiles (Clothing and Furnishing) in 2011-12

State	Consumption Expenditure (Rs. Crore)	Share in all State Consumption Expenditure (%)	Rank	State	Consumption Expenditure (Rs. Crore)	Share in all State Consumption Expenditure (%)	Rank
Uttar Pradesh	46,865	13.74	1	Uttaranchal	3,785	1.11	19
Maharashtra	40,297	11.81	2	Jam. & Kashmir	3,389	0.99	20
Andhra Pr.	29,399	8.62	3	Him. Pr.	2,863	0.84	21
West Bengal	24,153	7.08	4	Tripura	980	0.29	22
Bihar	21,084	6.18	5	Meghalaya	864	0.25	23
Tamil Nadu	20,010	5.86	6	Manipur	570	0.17	24
Rajasthan	19,775	5.80	7	Goa	544	0.16	25
Karnataka	18,098	5.30	8	Nagaland	525	0.15	26
Gujarat	16,693	4.89	9	Pondicherry	458	0.13	27
Madhya Pr.	15,373	4.51	10	Arun. Pradesh	413	0.12	28
Kerala	14,035	4.11	11	Chandigarh	401	0.12	29
Haryana	12,299	3.60	12	Mizoram	399	0.12	30
Punjab	11,330	3.32	13	Sikkim	258	0.08	31
Orissa	8,421	2.47	14	A & N Islands	225	0.07	32
Delhi	7,699	2.26	15	D & N Haveli	101	0.03	33
Jharkhand	7,240	2.12	16	Daman & Diu	58	0.02	34
Chhattisgarh	6,506	1.91	17	Lakshadweep	24	0.01	35
Assam	6,070	1.78	18	All States	3,41,205	100.00	

Source: National Accounts Statistics 2011-12, Household Consumption Expenditure Survey, NSSO 2011-12, EY Analysis

Uttar Pradesh, the most populous state in India also has the largest share of consumption. However, its share of national population (16.9%) is much higher than its share of national consumption (13.7%) of textiles. Maharashtra on the other hand accounts for a larger share of national consumption of textiles (11.8%) as compared to its share of national population (9.4%). This can be largely attributed to the high per capita GSDP of Maharashtra which is more than three times that of Uttar Pradesh. Similarly Andhra Pradesh, West Bengal and Bihar account for 8.6%, 7.1% and 6.2% of the national final consumption expenditure on textiles respectively although their share of national population is in the reverse order – 7.1%, 7.5% and 8.2% respectively. The per capita GSDP of Andhra Pradesh is about thrice the GSDP of Bihar while that of West Bengal is a little more than twice that of Bihar.

Thus relatively lower per capita income states such as Jharkhand, Assam, Uttarakhand and smaller states of the North-east such as Tripura, Meghalaya, Manipur, Mizoram and Nagaland are ranked relatively lower in the ranking according to share in consumption expenditure. Despite being much smaller in terms of area and population, Delhi's share of national consumption of textiles is 0.2% and 0.4% more than the share of Jharkhand and Chhattisgarh respectively. Thus it has the maximum textile consumption amongst all Union territories.

Major textile producing states such as Tamil Nadu, Gujarat, Karnataka and Punjab are also ranked within the top half of textile consuming states in the nation, with shares of 5.9%, 4.9%, 5.3% and 3.3% respectively.

1.2.3 Exports

In the global exports of textiles, India is ranked as the third largest exporter, trailing EU-27 and China, as per WTO data – 2011. Table 1.3 gives the share of India in world textile and clothing exports. In the global clothing export market, India ranked as the fifth largest exporter as per WTO data – 2011, trailing Bangladesh, Hong Kong, EU-27 and China. Its share in world textile exports has increased from 3.5% in 2004 to 5.1% in 2011. Similarly India has gained a 0.9% share in world exports of clothing over the same period.

Table 1.3: India's Share in World Textile and Clothing Exports

(in billion US\$)

Year	Textiles			Clothing		
	World Export	India's Exports	India's %age share in world exports	World Export	India's Exports	India's %age share in world exports
2004	195.0	6.9	3.5	258.0	6.6	2.6
2005	203.0	7.9	3.9	276.0	8.3	3.0
2006	218.6	9.3	4.3	311.4	10.2	3.3
2007	241.3	9.8	4.1	347.1	9.9	2.9
2008	253.4	10.5	4.1	364.9	11.5	3.2
2009	211.1	9.1	4.3	315.6	11.5	3.6
2010	251.0	12.9	5.1	351.0	11.0	3.1
2011	293.5	15.0	5.1	412.5	14.4	3.5

Source: International trade statistics 2012, WTO Secretariat

Table 1.4 gives the major export destinations of India's textile and clothing products. India's major textile and clothing export destinations include the US, China, UAE, UK, Germany and Bangladesh comprising 18.2%, 11.9%, 6.6%, 6.3%, 4.8% and 5.1% respectively of the total textile and clothing exports from the country in 2012. There has been a gradual shift of exports towards Asian nations over the three calendar years 2010 to 2012. The major Asian export destinations accounted for 20.9% of India's textile exports in 2012, with China (11.9%) as the clear leader amongst them. Their share has increased by 3.4% points since 2010. However, the US still remains the single largest nation importing textile and clothing from India with its share remaining more or less constant over the three years 2010 to 2012. Major EU destinations constituted 16.2% of the total exports in 2012, a decline from 18.6% in 2010 and 20.0% in 2011. This can be attributed to the drop in economic activity across the EU due to the debt crisis faced by many countries such as Italy, Spain etc.

Table 1.4: India's Textile & Clothing Exports to Selected Countries

(in million US\$)

Partner Country	2010	2011	2012
World	27,188	32,642	32,845
United States	4,946	5,779	5,994
China	2,325	2,928	3,907
United Arab Emirates	1,798	2,162	2,172
United Kingdom	1,667	2,087	2,080
Germany	1,528	1,959	1,567
Bangladesh	1,105	1,101	1,659
Italy	778	1,030	774
France	810	1,017	823
Spain	667	814	732
Turkey	667	731	659

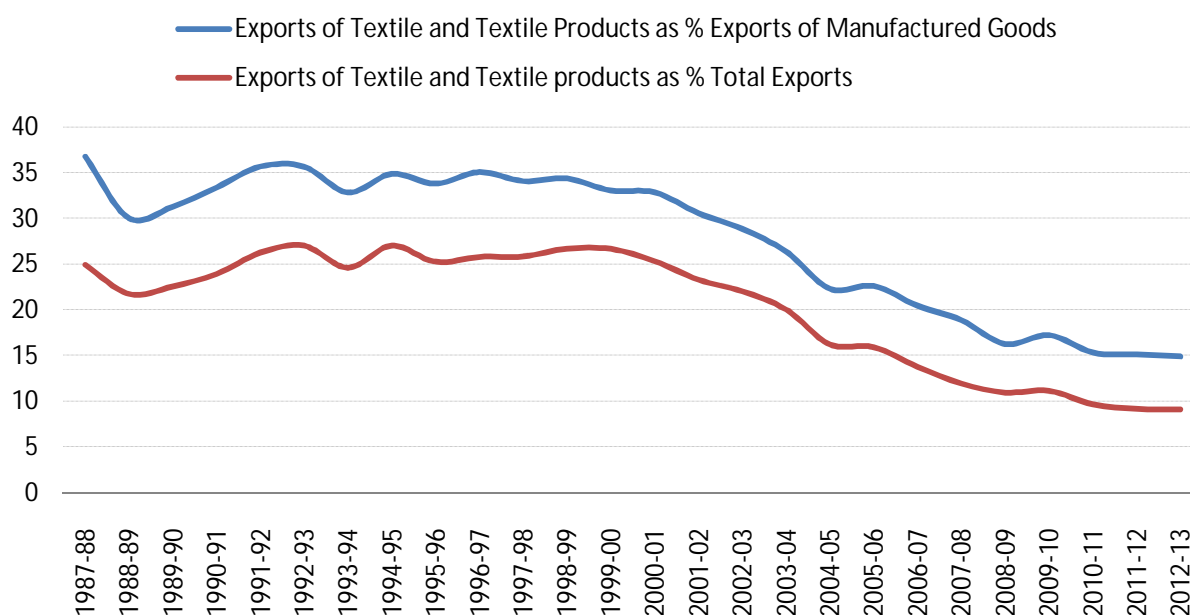
Source: Ministry of Textiles

A notable trend is the falling share of exports of textile and textile products as a percentage of total exports (both measured in rupee terms) and also as a percentage of exports of manufactured products. As indicated in Chart 1.1, there has been a steady fall in these two shares since FY01. This has happened in spite of a number of export promoting measures related to the textile sector.

At the same time, many countries including the US are putting pressure on India to withdraw subsidies or support to the textile sector. This is because as per the WTO rules it has crossed the export competitiveness threshold, defined as achieving 3.25% of world trade in the sector. A key issue therefore is whether and under what conditions the introduction of GST would improve the productivity and competitiveness of exports of textile and textile products. If under GST, certain textile segments require additional or redesigned subsidies, the best methods of managing this need to be identified.

Figure 1.2 shows the gradual fall in the share of textile exports in total exports and exports of manufactured products. As shown in Table 1.5, the reason for the fall in the share of textile exports relative to total exports in India is that the rest of the exports have grown at a rate much faster than that of textiles. Exports of engineering goods, petroleum products, gems and jewellery and chemical products have grown at a faster pace, exceeding the value of textile exports. In 2012-13, the share of textile and textile products in exports of all commodities had declined to 9.1% of the total exports whereas the share of engineering goods, petroleum products, gems and jewellery and chemical products had increased to 21.7%, 20.0%, 14.5% and 13.3% respectively.

Figure 1.2: Share of Textile Exports in Total Exports and Exports of Manufactured Products



Source: RBI

Table 1.5: Share of Exports of Principal Commodities in Total Commodity Exports

Year	Percent										
	Agri. and Allied Prods	Ores and Mineral	Leath. and Manuf.	Chem. and Related Prods	Engineering Goods	Textile and Textile Prods	Gems and Jewellery	Handicrafts (excl. Handmade Carpet)	Other Manuf. Goods	Petroleum Prods	Others (All Commodities)
2000-01	13.4	2.6	4.4	13.2	15.3	25.3	16.6	1.5	0.8	4.2	2.8
2001-02	13.5	2.9	4.4	13.8	15.9	23.3	16.7	1.3	0.9	4.8	2.7
2002-03	12.7	3.8	3.5	14.1	17.1	22.0	17.1	1.5	0.9	4.9	2.3
2003-04	11.8	3.7	3.4	14.8	19.4	20.0	16.6	0.8	1.0	5.6	2.9
2004-05	10.1	6.1	2.9	14.9	20.8	16.2	16.5	0.5	1.0	8.4	2.7
2005-06	9.9	6.0	2.6	14.3	21.1	15.9	15.1	0.4	1.0	11.3	2.4
2006-07	10.0	5.5	2.4	13.7	23.4	13.7	12.6	0.3	1.0	14.8	2.4
2007-08	11.3	5.6	2.2	13.0	22.9	11.9	12.1	0.3	0.8	17.4	2.5
2008-09	9.6	4.3	1.9	12.4	25.9	10.9	15.3	0.2	0.7	14.7	4.1
2009-10	10.0	4.9	1.9	12.9	21.5	11.1	16.3	0.1	0.9	15.7	4.8
2010-11	9.7	3.4	1.6	11.5	23.2	9.7	16.1	0.1	0.8	16.5	7.4
2011-12	12.3	2.8	1.6	12.1	22.2	9.2	14.7	0.1	0.8	18.3	6.1
2012-13	13.5	1.8	1.6	13.3	21.7	9.1	14.5	0.1	0.9	20.0	3.5

Source: Database on the Indian Economy, RBI

As given in Table 1.6, data provided by the WTO shows that India's share of world exports has increased despite the decrease in its share of textile exports in the domestic economy. Thus Indian textile exports have grown faster than the global demand for imported textiles. However, India has consistently underperformed as compared to China (Table 1.6). While India's share of global exports has grown from 2.2% in 1990 to 4.1% in 2012, the share of China has grown from 7.9% to 36.0% over the same period.

Table 1.6: Share of World Exports of Textile and Clothing (in US\$)

Country	Percent				
	1990	2000	2010	2011	2012
India	2.2	3.3	4.0	4.2	4.1
China	7.9	14.8	34.1	34.9	36.0

Source: International Trade Statistics, WTO Secretariat

The dismantling of the Multi Fibre Agreement in 2004 was expected to provide a big boost to India's textile exports. However, India has not performed upto the expectations. As of now, it is facing competition not only from China, but also from smaller economies like Korea, Bangladesh and Pakistan.

Table 1.7: Growth rate of Textile Exports: CAGR of Exports in Rupee terms

#	Commodity/Years	FY91-95	FY95-00	FY00-05	FY05-13
1	Cotton Yarn, Fabrics, Madeups, etc.	35.20%	13.80%	3.00%	12.90%
2	Natural Silk Yarn, Fabrics, Madeups, etc., incl. Silk Waste	16.10%	20.00%	11.30%	-8.30%
3	Manmade Yarn, Fabrics, Madeups, etc.	47.60%	12.80%	20.20%	13.70%
4	Manmade Staple Fibre		18.70%	15.90%	27.50%
5	Woollen Yarn, Fabrics, Madeups, etc.	73.10%	2.60%	7.70%	9.70%
6	Readymade Garment	26.60%	14.90%	7.40%	11.50%
7	Jute & Jute Manufactures	12.20%	2.90%	17.90%	6.80%
8	Coir & Coir Manufactures	37.70%	3.00%	18.90%	10.70%
9	Carpets	27.30%	9.70%	0.50%	8.20%
10	All Textile and Textile Products	30.10%	13.80%	7.40%	11.80%

Source: Reserve Bank of India

Table 1.7 gives the growth rates for exports in rupee terms for selected textile items. The man-made (MM) fibres and MM-fibre based yarn and fabrics show relatively higher growth rates in more recent periods indicating that support to the MM fibre sector would facilitate buoyant export growth.

1.2.4 Utilization of Raw Materials

Consumption data are available for raw cotton, man-made fibres and man-made yarn. The consumption of other fibre/yarn including wool and silk yarn is also available from the Office of Textile Commissioner. Table 1.8 gives details of the consumption of various raw materials.

Wide availability and favourable physical characteristics make cotton one of the most favoured materials for clothing in India. Domestic support as well as India's large exports of cotton products make the consumption of raw cotton far outweigh the consumption of any other natural or man-made fibre. The consumption of cotton fibre reached 3,972 million kgs in 2011-12 from 3,707 million kgs in 2007-08, an increase of 15.2% over the four year period. It fell by 9.2% the following year but was still more than the level seen in 2009-10. Overall, consumption of cotton fibre has grown at a CAGR of 1.7% during the four year period 2008-12.

Consumption of man-made fibre has been around 1,000 million kgs during the five years 2007-08 to 2011-12 except for a slight drop in 2008-09. Viscose and polyester fibres are the largest consumed man-made fibres in India comprising on an average 23.6% and 67.8% of the total man-made fibres respectively. The trend of consumption of viscose and polyester has largely been the same across the five years 2007-12. There was a drop in consumption of both the fibres in 2008-09 but it picked up the following year.

During the period 2007-12 filament yarn consumption has been 28% more than man-made fibre consumption on an average. More than 90% of the filament yarn consumed is polyester yarn. Consumption of polyester filament yarn increased by 4.8% in 2008-09 and reached 1,342 million kgs. It remained more or less constant the next year but has declined by 16.7% to 1,106 million kgs in 2011-12.

The consumption of other textile materials including wool and silk constituted 2.5% of the total textile raw material consumption on an average during the five years 2007-12. Their consumption has remained more or less constant at near 160 million kgs per annum.

Table 1.8: Consumption of Various Textile Raw Materials

Item	Units	2007-08	2008-09	2009-10	2010-11	2011-12 (P)
Cotton (Mill consumption SSI & Non-SSI)	Million kg	3,707	3,581	3,796	4,374	3,972
	Lakh bales	218	211	223	257	234
Man-made Fibre						
Viscose staple fibre	Million kg	250	221	268	263	246
Polyester staple fibre	Million kg	739	653	726	756	704
Acrylic staple fibre	Million kg	95	89	96	69	86
Polypropylene staple fibre	Million kg	3	3	3	3	4
Sub-Total	Million kg	1,087	966	1,093	1,091	1,040
Man-made Filament Yarn						
Viscose filament yarn	Million kg	42	45	49	49	45
Polyester filament yarn	Million kg	1,281	1,342	1,327	1,221	1,106
Nylon filament yarn	Million kg	29	31	29	30	32
Polypropylene Filament Yarn	Million kg	12	16	13	15	14
Sub-Total	Million kg	1,364	1,434	1,418	1,315	1,197
Others (silk, wool etc.)	Million kg	160	159	159	159	165
Total	Million kg	6,318	6,140	6,466	6,939	6,374

Source: Office of Textile Commissioner

1.2.5 Prices

There are several factors that affect the prices of cotton and man-made textiles. Some of these are:

- ▶ Extent of agricultural output
 - Productivity of BT cotton
 - Land under cotton cultivation – depends upon availability of black soil

- Adequate monsoon
- Technology used for spinning, weaving, processing
- ▶ Demand for Clothing which depends upon
 - Income
 - Preferences
 - Prices

One of the major factors affecting the prices of man-made fibres is the price of its raw materials, that is, the international price of crude oil, chemicals and dyes. Besides, through the substitution effect the price of natural raw materials such as cotton, silk etc. also affects the demand and consequently the price of manmade fibres.

The prices of three varieties of cotton yarn along with the price of polyester staple fibre, polyester filament yarn, texturised (a variety of polyester yarn) yarn and raw wool for the period FY2003-13 are given in Table 1.9.

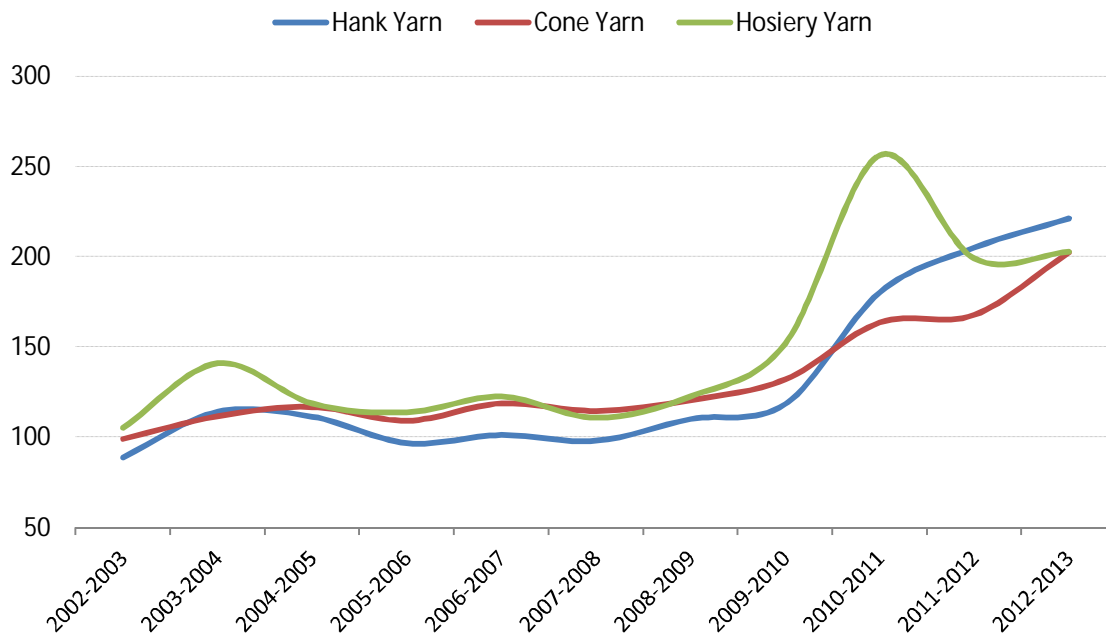
Table 1.9: Prices of Various Textile Inputs

Year	Cotton Yarn			PSF (Avg.)	PFY (126 D) (Avg.)	Texturised Yarn (Avg.)	Raw Wool (Imported Merino Wool) (Avg.)
	Hank	Cone	Hosiery				
	Wtd Avg	Wtd Avg	Wtd Avg				
2002-2003	88.84	99.02	105.14	63.34	89.28	95.94	284.02
2003-2004	114.09	111.58	141.00	70.88	95.90	92.17	334.40
2004-2005	111.41	116.75	118.67	78.01	93.80	97.07	267.07
2005-2006	96.77	109.14	113.75	73.59	95.64	87.01	250.78
2006-2007	101.21	118.80	122.50	74.18	91.56	87.56	286.80
2007-2008	97.98	114.59	110.75	66.78	84.03	88.08	348.39
2008-2009	110.03	120.58	122.63	70.06	78.91	92.58	316.56
2009-2010	118.35	131.99	151.88	69.00	79.66	93.23	342.31
2010-2011	180.30	163.60	256.25	87.26	96.67	102.94	437.06
2011-2012	205.08	167.83	199.00	103.31	112.36	112.97	682.04
2012-2013	221.23	202.50	202.83	104.33	119.40	118.15	744.76

Source: Ministry of Textiles

Figure 1.3 delineates the price movements of hank, cone and hosiery cotton yarn. The prices of various types of cotton yarn were almost flat during the first half of the last decade till 2008-09. However in 2009-10 prices started increasing and shot up in the 2010-11. Hank yarn, cone yarn and hosiery yarn prices shot up by 53.2%, 23.9% and 68.7% respectively in 2010-11 over the previous year. Growth in hank yarn prices moderated to 13.7% in 2011-12 while cone yarn price increased by 2.6%. Hosiery prices, on the other hand, declined by 22.3% in the same year. Prices grew moderately in 2012-13 for hank and cone yarn but remained mostly flat for hosiery yarn. Overall in 2012-13 prices of hank yarn, cone yarn and hosiery yarn were 1.9, 1.5, and 1.3 times their price in 2009-10 respectively.

Figure 1.3: Price Trends of various types of Cotton yarn (Rs/kg)

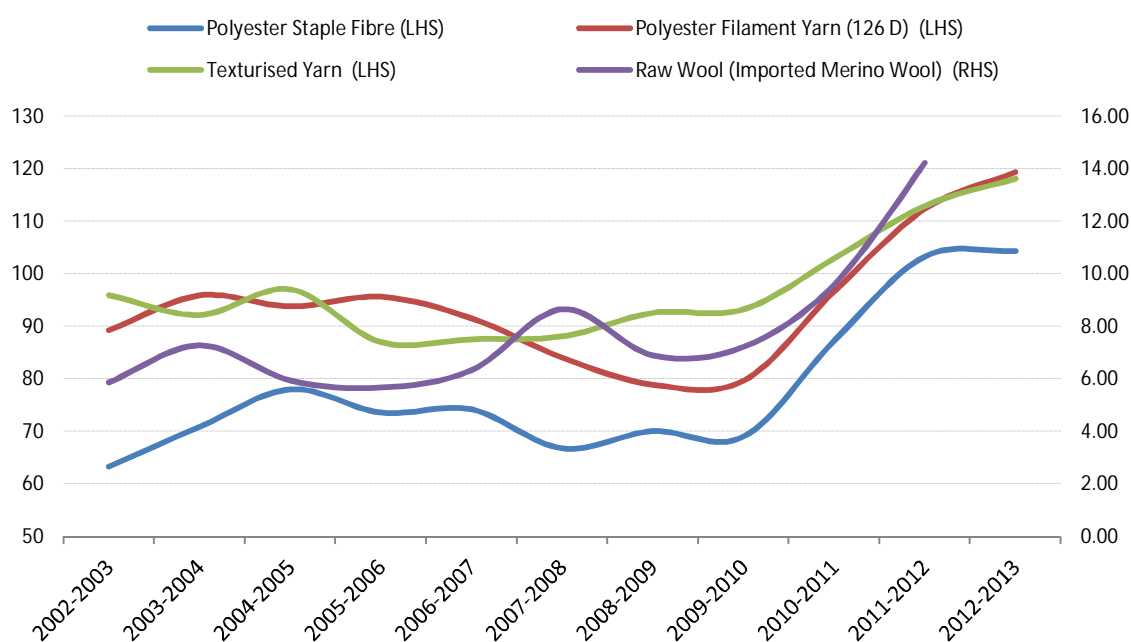


Source: Ministry of Textiles

Figure 1.4 shows the price trend of man-made fibres, filament yarn and wool during the ten year period ending 2012-13. The prices of polyester staple fibre (PSF), polyester filament yarn (PFY) and blended textile yarn increased at a high rate from 2010-11 onwards after declining gradually during the previous seven years. In 2010-11 their prices shot up along with that of natural fibres. The prices of PSF, PFY and textile yarn increased by 26.5%, 21.4% and 10.4% respectively in 2010-11. This trend of high growth continued in 2011-12 after which growth rates tapered down to single digit rates in 2012-13.

65% of the wool consumed in the Indian textile industry is imported. Hence its price is affected by movement in the exchange rate as well as the international price of wool. To weed out the impact of movement in the price of rupee, the average annual prices of wool were converted to dollars using the annual exchange rates published by RBI. For the four years from 2002-03 to 2006-07 the price of wool was relatively stable between US\$5.8/kg and US\$6.4/kg except for a short spike in 2003-04. 2007-08 witnessed a sudden increase of 36.7% in its price from US\$ 6.3/kg in the previous year to US\$ 8.7/kg. Price fell below US\$ 7/kg in the following year but rose consistently till 2010-11. In 2011-12 prices shot up by 48.4% to US\$14.3/kg. In 2012-13 growth in prices in rupee terms slowed down to 9.2%. Overall, prices increased 2.4 times over the 9 year period ending 2011-12.

Figure 1.4: Price Movement: Man-made Fibres and Wool (Rs./kg)



Source: Ministry of Textiles

1.3 Summary

Cotton textile is the dominant textile produced and consumed in India largely due to favourable natural conditions for its growth and use. However, as observed from global trends, the future growth of textiles in India would be mainly in man-made textiles. Currently, cotton is used either in pure form or in a blend with other fibres in over 60% of the total fabric produced in India. In terms of weight, the total amount of raw cotton consumed in India is more than thrice the amount of man-made fibre consumed. On the other hand, the final consumption of textiles is dependent upon both income and population. The top five states comprising almost half of the national share of textile and clothing consumption are UP, Maharashtra, Andhra Pradesh, West Bengal, Bihar and Tamil Nadu.

Prices of most textile raw materials in terms of rupees remained nearly flat for most types of fibres, yarn and raw wool during the period 2002-09. However the price of crude, which serves as a raw material for man-made fibre, rose sharply in 2010-11. As a result prices of man-made fibres rose sharply in 2010-11. The same year also witnessed an increase in prices of other textile raw materials such as cotton. Prices of raw materials have continued to rise since.

In terms of exports the Indian textile sector has progressed at a slow pace. Although the world share of exports of Indian textiles and clothing has risen by 1.9% points during the period 1990-2012, China has grown at a much faster pace gaining 28.1% points over the same period. Moreover, the share of total Indian textile and clothing exports has reduced by more than 15% points since 2000-01.

From a perspective of growth in both domestic consumption and exports, greater focus is required on man-made fibre production.

Chapter 2: Textile Value Chains

Textile value chains describe the conversion of inputs into outputs through various production processes. These descriptions capture not only the production process but also the value created through trading, transporting and marketing. These also describe the contribution of a variety of sub-processes and interactions between organized and unorganized sectors. Since taxation of textiles is mostly through inputs, understanding the value chain as the product moves from raw materials to finished products is of critical importance both for understanding the current system of taxation and the impact of the goods and services tax. We look at the overall production process and value addition segment by segment.

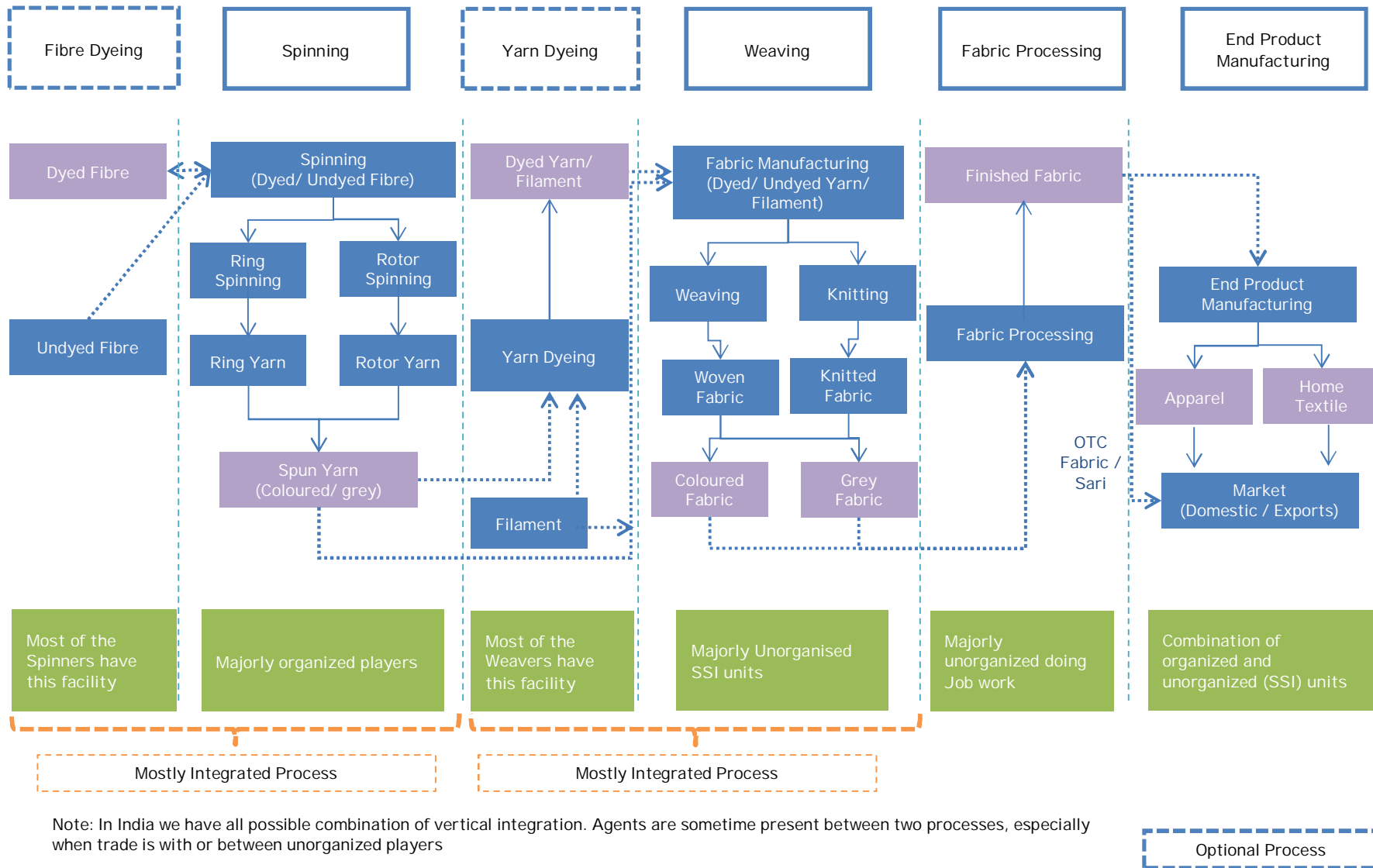
2.1 Value Chain: Overall Textile Sector

Indian textile and apparel sector is fragmented into organized and unorganized sectors. The unorganized sector primarily consists of handloom, small scale mills and medium scale mills while organized sector has large scale units with high production capacity. This structure allows the textile and apparel sector to cater to both large and small customers.

Figure 2.1 depicts the typical production process of value addition in textiles as we move from raw materials to finished products. The value chains of cotton, man-made fibre and wool most closely resemble the typical all-segment value chain. This is described below.

The constituents of the various textile segments described subsequently are given in Annex 11.

Figure 2.1: Textile Value Chain: Typical All-Segment Pattern

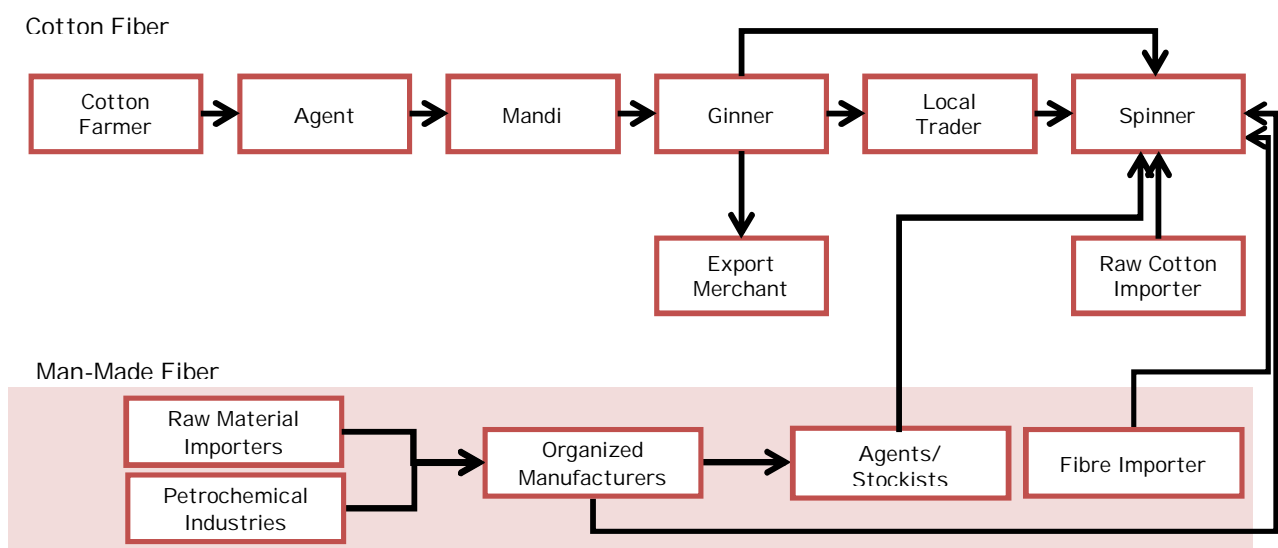


2.2 Cotton Textiles and Man-made Textiles

The cotton textile category in the Input-Output Matrix covers cotton ginning, cleaning and baling, spinning, weaving and finishing of cotton textiles in mills and power looms, printing, dyeing and bleaching of cotton textiles and cotton textiles not elsewhere classified. Since the value chain of cotton and man-made fibres are similar they are explained together in this section.

Figure 2.2 gives the broad structure of the cotton and manmade textiles value chain. The cotton and man-made fibre value chain covers approximately 90% of the textile sector value-chain. While the cotton value chain is mainly spread across the states of Gujarat, Maharashtra, Tamil Nadu, Punjab and Madhya Pradesh, the value chain of man-made fibres is located primarily in the states of Maharashtra and Gujarat.

Figure 2.2: Value Chain: Cotton Textiles/ Manmade Fibre Textiles



Source: Industry analysis

The value-chain of cotton fibre starts with raw cotton being sold by the farmer through an agent or a chain of agents to various Mandis in the state. The ginner purchases the raw cotton from the mandi, separates the fibre from the seeds and presses and bales the cotton. The ginned cotton thus prepared is either sent for spinning or is also directly exported. The export of cotton happens through an export merchant while ginned cotton reaches the spinner through the following routes:

- ▶ Regular dealers or local traders working on commission basis
- ▶ Directly through purchase from a ginner by an employee of the spinner
- ▶ Import of raw cotton from an importer

Few spinners own ginning units but it hardly covers 10% of the total fibre requirement.

Man-made fibres come in two forms – staple fibre and filament. A staple fibre is a short fibre of a standard length. Filament, on the other hand, consists of long continuous strands which have been twisted or grouped together.

As compared to cotton, the value chain of man-made fibre is much more organized with lesser involvement of local agents. Except for regenerated fibres like viscose, rayon,

etc. all the man-made fibres are synthesized with products derived from petroleum forming the primary ingredients/monomers.

The petrochemical companies supply the raw materials like petroleum products and their derivatives directly to the fibre manufacturers while other companies supply the chemicals utilized in manufacturing process. Raw materials are also imported through an importer. The manufacturers develop the various fibres and supply them to the spinner

- ▶ Either directly
- ▶ Or indirectly through an agent/stockist

Man-made fibres are also imported by an importer to fulfil the fibre requirement.

Once the ginned cotton fibre (in the case of cotton) or the man-made fibre is received by the spinner, he has the option of getting the fibre dyed before it is actually spun. If the fibre is to be dyed first, the process is either outsourced or conducted in-house depending upon the availability of the facility. However, the two processes are generally integrated.

Spinning can be of two types – ring spinning which results in the creation of ring yarn, or rotor spinning which results in the creation of rotor yarn. Depending upon whether the fibre spun is dyed or undyed, the yarn created is either coloured or grey. The spun yarn too can be of three types – cone, cheese or hank. Hank, used in the handloom sector, is exempt from tax. Depending upon the requirement, cheese yarn too is converted to hank for use in the handloom sector. However spinning is not required in case of man-made filament. It is directly sent to dyeing or fabric manufacturing process.

The organised sector dominates the process of spinning. This largely consists of large integrated mills or power looms in the small scale sector. Almost all these firms are registered with the respective State VAT authorities and the Central Excise Department given the minimum threshold levels for registration. A turnover of Rs. 5-20 lakh and an investment of over Rs. 1.5 crore require registration with the State VAT authorities and Central excise department respectively. The relationship between the spinning and the dyeing companies is governed by the Works Contract Rules of the respective VAT Acts of respective state governments.

After spinning, the yarn or filament produced is generally dyed, if not already done so. Post dyeing, the yarn is either woven or knitted into a fabric. As in spinning, the process of dyeing and weaving is generally integrated with most of the weavers having this facility. Dyeing is also sometimes skipped altogether where spun yarn is directly sent for weaving or knitting. Depending upon whether the yarn/filament used was dyed or not, coloured or grey fabric is manufactured. The dyeing and fabric manufacturing sector is primarily unorganized and mainly comprises Small Scale Industries (SSI) weaving units.

The fabric so knitted or woven is sent for further processing consisting mainly of chemical or mechanical treatment. Chemical treatment is undertaken with the purpose of imparting desired physical properties (wrinkle-free, glossy etc.) to the fabric. Treatment of sand may also be given to impart the desired look (faded) to the fabric. Moreover, if the fabric has not been dyed so far, it is done so at this stage. After processing, the fabric is finished. Finishing consists of processes such as raising, calendaring, and shrinking to obtain the desired feel of the fabric. Processing and finishing are generally done in the same unit. The finished fabric is either sold over-the-

counter or exported by firms. The fabric processing sector is a majorly unorganized sector with small firms undertaking job work.

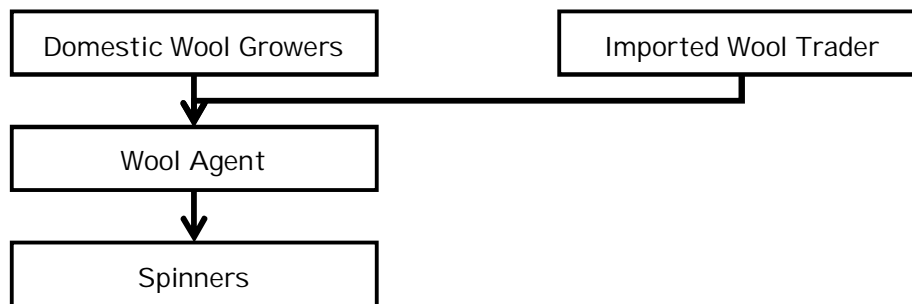
The finished fabric goes to garment factories or home textiles manufacturing companies. They convert the fabrics into end-products such as home textile or apparel which are either sold in the domestic market or exported. This sector is a combination of both organized manufacturers and unorganized SSI units.

2.3 Woollen Textiles

The segment of woollen textiles covers wool cleaning, baling and pressing, wool spinning, weaving etc. (handloom, powerlooms and mills) besides dyeing, bleaching and manufacture of woollen blankets, shawls, felts and others.

Figure 2.3 gives the major stages of the value chain of woollen textiles while Figure 2.1 lays down the detailed structure of the typical value-chain.

Figure 2.3: Major stages in the value chain of Woollen Textiles



Source: Industry analysis

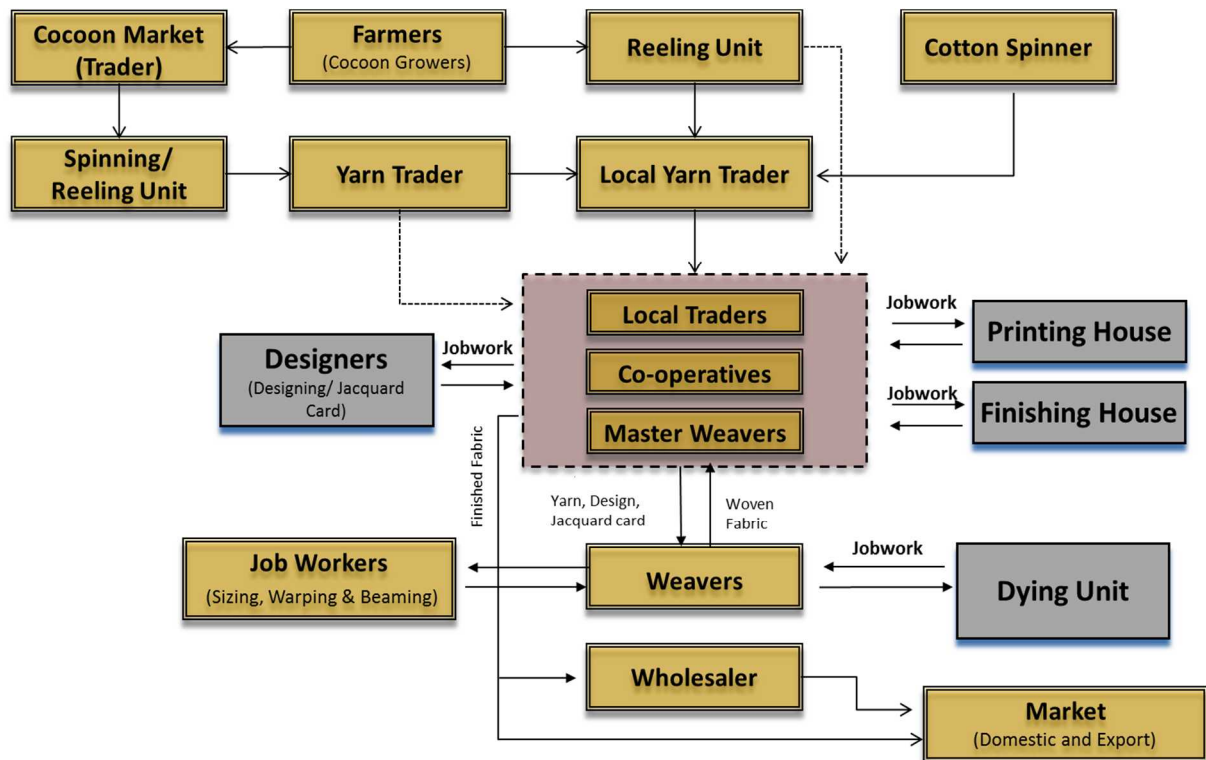
The typical all-segment value-chain closely resembles the woollen textile value-chain as well. The value chain for wool starts with purchase of raw wool from domestic growers of wool by agents who further sell it to spinners and earn a commission.

However, only 7% of India's raw wool requirement for all usage except carpets is fulfilled through procurement from domestic wool growers while rest of the demand is fulfilled through imports. Low consumption of indigenous wool is because of the coarseness and low quality of the fiber, which cannot be used for producing fine yarns. A wool trader imports the wool and supplies it to the wool agent who further sells it to the spinner. The rest of the value-chain for wool consisting of the stages of dyeing, weaving, fabric processing and end-product manufacturing remains the same as that of cotton. The only minor difference is that wool fibre is only ring spun not rotor spun. Rotor spinning is not used on wool fibres as these are long fibres while rotor spinning is generally used to spin shorter fibres.

2.4 Handlooms

About 95% of the world's hand woven fabrics come from India. Figure 2.4 gives a concise picture of the handloom value chain.

Figure 2.4: Value Chain: Handloom Sector



Source: Industry analysis

The handloom sector majorly uses cotton and silk for all its products. Spun cotton, 'reeled silk yarn' or 'spun silk yarn' are purchased by yarn traders from the respective reeling or spinning units. This is sold to the local yarn trader in touch with the handloom weavers. The local yarn trader further sells the yarn to the three prominent operators in the handloom value chain:

- **Master Weavers:** They own multiple looms and arrange for the procurement of raw material, working capital requirements etc. They generally employ weavers on job work basis for the weaving process. They may or may not be registered.
- **Co-operatives:** The weavers often group themselves and register into cooperatives. This enables them to avail subsidies and obtain finance. However it is estimated that majority of the registered cooperatives are non-functional.
- **Local Traders:** They provide monetary support services like money lending etc. to cooperatives, master weavers and weavers. They may or may not be registered.

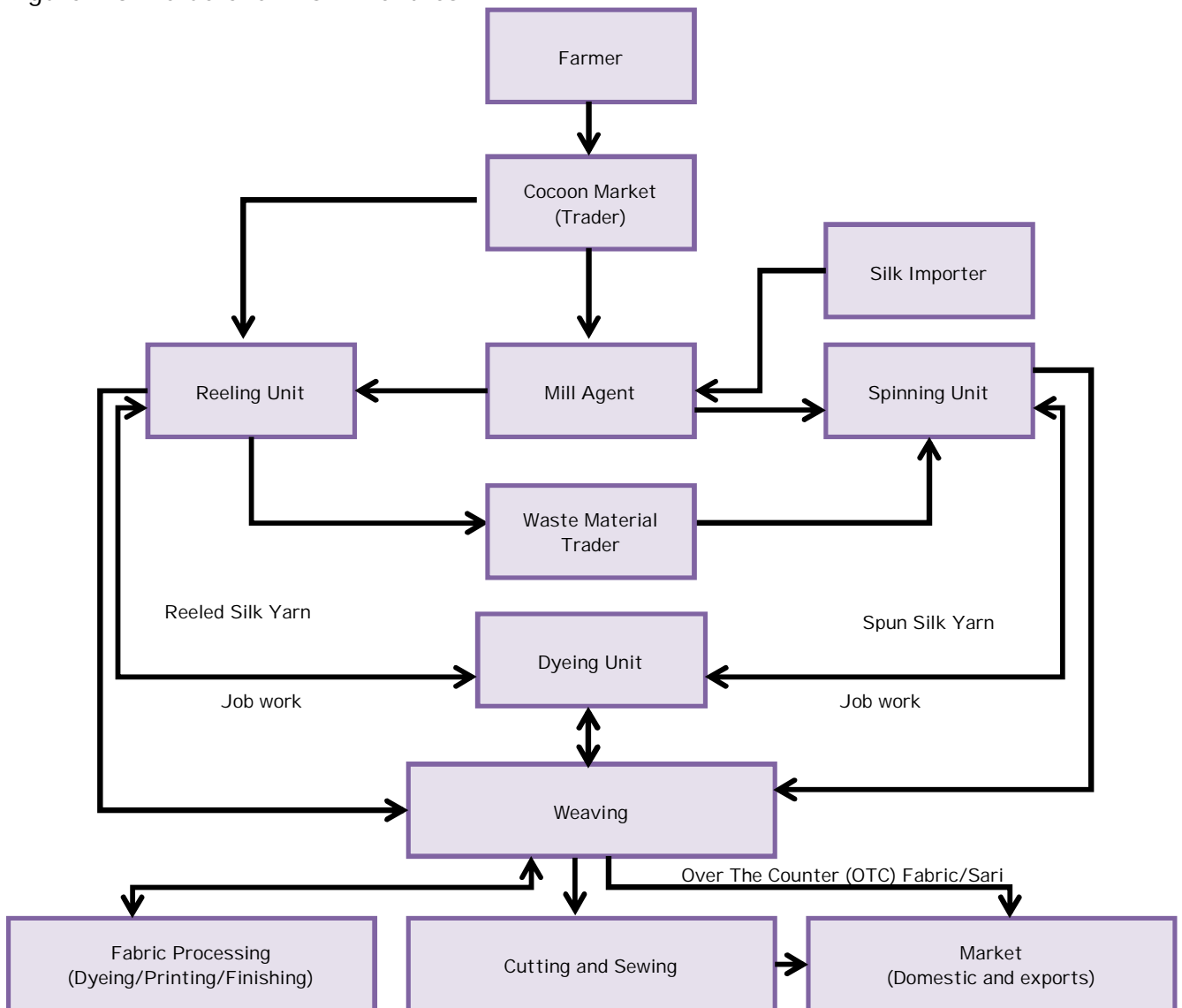
Cooperatives and local traders form the background support for the master weavers and weavers. Preparatory processes, i.e. sizing, warping and beaming are carried out on job work basis. They also outsource designing and punching of the jacquard cards to designers. The jacquard card contains holes punched in a card which correspond to one row of the design. The yarn bought from yarn trader is sent to the weavers who get them dyed, as per the requirement, on job work basis. Once the cards are prepared and handed over by the designers to the master weavers or cooperatives, individual weavers are employed to weave the dyed / undyed yarn into fabric. This dyed and

woven fabric is sent to the master weavers. Next, they get the work of printing and finishing done on the fabric on job work basis. Separate units exist for printing and finishing. Like the cotton value chain, finishing consists of imparting desired physical properties to the fabric such as making it water repellent or wrinkle-free. The fabric so manufactured is sold either directly in the market or through wholesalers. A large amount is also exported to various countries such as the US, Germany, the UK, France and Italy.

2.5 Silk Textiles

Silk Textiles cover spinning, weaving, finishing, printing, dyeing and bleaching of silk textiles. Figure 2.5 gives the structural breakdown of the value-chain of silk textiles in India.

Figure 2.5: Value Chain: Silk Textiles



Source: Industry Analysis

The value chain of silk starts with the farmer selling the cocoon to a trader in the cocoon market. The silk procured is of two types.

- ▶ Cut cocoon where the pupa has emerged from the cocoon before being discovered
- ▶ Uncut cocoon where the pupa has not left the cocoon

If the cocoon has been cut by the pupa, then the fibre from it is torn into shorter lengths while where the pupa has not emerged, the cocoon can be unravelled as one continuous thread. The cut cocoon is supplied to the spinning unit mainly through the mill agent. The uncut cocoon is supplied to the reeling unit either directly by the trader in the cocoon market or through a mill agent. The mill agent also imports raw silk and supplies it to the reeling unit.

Separate units are used for reeling and spinning silk. The waste produced from the reeling unit is sold to a waste material trader who then sells it to spinning units where it is utilized in producing silk yarn. The reeled silk yarn or spun silk yarn, as the case may be, is either sent for dyeing or is sent to a weaving unit for fabric manufacturing.

Dyeing of the yarn is done in-house or is sometimes outsourced on job work basis. The dyed yarn is supplied back to the spinning or reeling unit.

Weaving unit source the spun/reeled silk yarn either in raw or dyed form. Weavers get the raw yarn dyed majorly on job work basis as per its requirement. Once woven, the fabric is sent for processing. Processing involves the complete process of dyeing (where not done earlier), printing and finishing the silk fabric. The weaving units either outsource further processing of the fabric or establish in-house facilities where it can be done. The processed fabric is either sold directly or is cut and sewn into apparels or home textiles. The fabric for sari is cut into certain length and the ends of it are locked either by hemming or by tying a knot. These are subsequently sold in the domestic market and/or exported.

One unique characteristic of the silk value chain is it mainly consists of standalone units. There are very few integrated units with integration being possible mainly in the processes of reeling, spinning and dyeing. Some of the weavers may also have an integrated dyeing unit.

2.6 Artificial Silk, Synthetic Fibre Textiles

This category includes spinning, weaving and finishing of synthetic fibres, rayons, nylons etc. besides printing, dyeing and bleaching of synthetic textiles, other silk and synthetic fibre textiles. The value chain for artificial silk (viscose) and synthetic fibres is almost the same as that of cotton and is hence explained along with the value chain of cotton.

2.7 Jute, Hemp, Mesta Textiles

This category covers pressing, baling, spinning and weaving, finishing of jute, mesta, hemp and other coarse fibre, dyeing, printing and bleaching of jute textiles,

manufacture of jute bags and other jute textiles. Jute is the dominant textile in the category. The value chain is depicted in the form of a figure given in Annex 8.

The jute industry is predominantly based out of West Bengal. Jute is chiefly used to make sacks for food grains and coarse fabric for wrapping bales of raw cotton. Lately, it has entered the apparel sector as well, albeit on a very small scale.

The value chain of jute starts with the sale of raw jute bales by farmers to mill agents through a single agent or a network of agents. Mill agents further sell the raw jute to the spinners. They also import jute and sell it to the spinners. The spinners convert the jute fibres into yarn which is sold either in the domestic market or exported. The domestic consumption of jute yarn is very limited and is mainly used to close the mouth of jute sacks.

Most of the jute yarn is sent to a weaving unit where it is converted into a fabric. This fabric finds good application in the geotextiles sector where it is utilized for road construction. Jute fabric is also exported due to its usage in geotextiles. One of the major applications of jute fabric is in the form of hessian fabric, which is widely used for packing purpose. Majority of the jute fabric sent from weaving unit is cut and sewn to produce jute sacks and other finished goods. Consumption of jute sacks in India is very high, mainly utilized for storing food grains and sugar. The jute sacks and other jute goods find good demand overseas and are exported to many countries as well.

The sector consists of mostly integrated units with the processes of spinning, weaving and sewing available under the same roof. Only few companies have standalone spinning units.

2.8 Carpet Weaving

The carpet industry in India mainly produces three types of carpets – tufted, knotted and woven carpets – all of which are hand-woven. Carpets are predominantly produced from wool though other materials such as cotton, polyester and viscose are also used in various blends.

The value chain of the carpet industry is depicted in Annex 9. The value chain of the carpet sector is unique in the sense that it centres around carpet manufacturers who typically have the in-house facility for finishing and dyeing only. They can be involved in any part of the value chain, directly or indirectly. They buy the wool fiber from agents who in turn procure it either from domestic wool growers or through imports. The manufacturers subsequently get the wool spun and dyed on job work basis. A similar process is followed for non-woollen yarn which is bought directly from their manufacturers or from their yarn agents. The yarn thus produced is sent by the carpet manufacturers through contractors who act as master weavers. They get the yarn woven from the weavers on job work basis. The woven carpet is finished in the in-house facility of the carpet manufacturers or through job work as applicable. The finished product thus produced is either sold to buying agents, domestic buyers or exported. The buying agents further sell the finished goods directly in the domestic market or export it.

2.9 Readymade Garments and Made-up Textiles

These are part of the value-chain of each of the above mentioned raw textile categories.

2.10 Miscellaneous Textile Products

This category includes cotton, woollen and synthetic fibres knitting in mills or otherwise, thread and thread ball making, jute, cotton, hemp, sisal, nylon rope, cordage and twines, nets, webbing, narrow fabrics, embroidery work, laces, fringes, zari and zari products, rain coats, hats, umbrellas etc., oil cloth, rubberised cloth, tarpaulin, artificial leather, made up canvas goods, coir fibre, yarn and coir products, linoleum and similar products, gas mantles and other textiles such as bandage, gauze, dressing cloth. Thus they are final products that are part of the value chain of either of the above value chains.

One point that needs to be noted is that value chain need not purely be of a single type of fibre. Infact in many cases more than one type of fibre are blended together. Thus at the fibre stage inputs from other textile sectors are also taken.

Chapter 3: Current Tax Structure

In this chapter, we provide an overview of the current domestic indirect taxes as these affect textile outputs and textile inputs, covering both major central taxes and state taxes. The main central indirect taxes are central excise duties or cenvat, customs duty and service tax. Since textiles are goods, the relevance of service tax is only with respect to service inputs into textile outputs. The main state taxes are sales tax/State VAT, tax on inter-state sales (also called the central sales tax) and entry tax. These pertain to textiles outputs as well as non-service textile inputs. A brief discussion of major taxes that would be subsumed in GST is given below. Annex 1 gives a brief description of customs duty. It would not be subsumed in GST.

3.1 Central Excise Duty

The Central Government levies excise duty under the Central Excise Act, 1944 and the Central Excise Tariff Act, 1985. Central excise duty is a tax which is charged on excisable goods that are manufactured in India and are meant for domestic consumption. The term "excisable goods" means goods, which are specified in the First Schedule and the Second Schedule to the Central Excise Tariff Act 1985. It is mandatory to pay Central Excise duty payable on the goods manufactured, unless exempted e.g., duty is not payable on the goods exported out of India. Further, various other exemptions are also notified by the Government from the payment of duty by the manufacturers.

Various Central Excise duties are as follows:

(1) Basic Excise Duty: Excise Duty, imposed under section 3 of the 'Central Excises and Salt Act' of 1944 on all excisable goods other than salt produced or manufactured in India, at the rates set forth in the schedule to the Central Excise tariff Act, 1985, falls under the category of Basic Excise Duty In India.

(2) Special Excise Duty: According to Section 37 of the Finance Act, 1978, Special Excise Duty is levied on all excisable goods that come under taxation, in line with the Basic Excise Duty under the Central Excises and Salt Act of 1944. Therefore, each year the Finance Act spells out whether the Special Excise Duty shall or shall not be charged, and eventually collected during the relevant financial year.

(3) Additional Duty of Excise: Section 3 of the 'Additional Duties of Excise Act' of 1957 permits the charge and collection of excise duty in respect of goods as listed in the Schedule of this Act.

(4) Other duties leviable as excise include road cess (additional duty of excise on motor spirit and high speed diesel oil), surcharge as special additional duty of excise on motor spirit, surcharge on pan masala and tobacco products, national calamity contingent duty (NCCD), education cess and cess on specific products. The scope of NCCD was extended in 2003 to polyester filament yarn.

3.2 Service tax

Service Tax is a tax that the service providers in India except those in the state of Jammu and Kashmir are required to pay under the provisions of the Finance Act of 1994. The provisions relating to Service Tax came into effect on 1st July, 1994. Under section 67 of this Act, the Service Tax is levied on the gross or aggregate amount charged by the service provider on the receiver. However, in terms of Rule 6 of Service Tax Rules, 1994, the tax is permitted to be paid on the value received. Service Tax is levied on all services except those specified in the negative list.

3.3 State Sales Tax/Value Added Tax

State VAT is a form of sales tax levied by the state governments on intra-state sale of goods. VAT is applied by the State governments at each stage of sale, with a particular apparatus of credit for the input VAT paid. VAT in India is classified under different rates. The typical slabs and rate structure is as follows: 0% for essential commodities, 1% on gold ingots and expensive stones, 5% (revised upwards from 4%) on selected goods including industrial inputs, capital goods and commodities of mass consumption, and 13.5% on other items in most states. There are state specific variations in the rates as also in the list of goods under different rate categories. Variable rates (State-dependent) are applicable for petroleum products, tobacco, liquor, etc. The levy of VAT is administered by the Value Added Tax Act and the rules made there-under which are similar to a sales tax. It is a tax on the estimated market value added to a product or material at each stage of its manufacture or distribution, ultimately passed on to the consumer. Under the current single-point system of tax levy, the manufacturer or importer of goods into a State is liable to sales tax. There is no sales tax on the further distribution channel. VAT, in simple terms, is a multi-point levy in the supply chain. The value addition at each stage is subject to tax.

VAT can be computed by using any of the three methods: (a) Subtraction method: The tax rate is applied to the difference between the value of output and the cost of input. (b) The Addition method: The value added is computed by adding all the payments that is payable to the factors of production (viz., wages, salaries, interest payments etc.). (c) Tax credit method: This entails set-off of the tax paid on inputs from tax collected on sales.

3.4 Tax on Inter-State Sales/Central Sales Tax

The Central sales Tax is a tax levied by the Union government but collected and retained by the state governments on inter-state sale of goods. It is currently charged at the rate of 2% on the value of sale of goods. Though the tax is levied by the central government, the revenues go to the state government from where the movement of goods commences. The objective of the Central Sales Tax levied through the Central Sales Tax Act 1956 was to prevent multiple levy of tax on the same goods by several states on the ground that one or more ingredient of sale was present in their state.

3.5 Entry Tax/Octroi/Local Body Tax

Entry tax is an account based tax levied and collected by state governments on entry of goods into a local area for consumption, use or sale therein. It was introduced by many states to replace Octroi, a local level levy imposed and collected by Municipalities/ Panchayats, on physical entry of goods. The basic philosophy behind the Entry tax was to do away with the system of local check-posts outside city limits, resulting in significant delay in movement of goods.

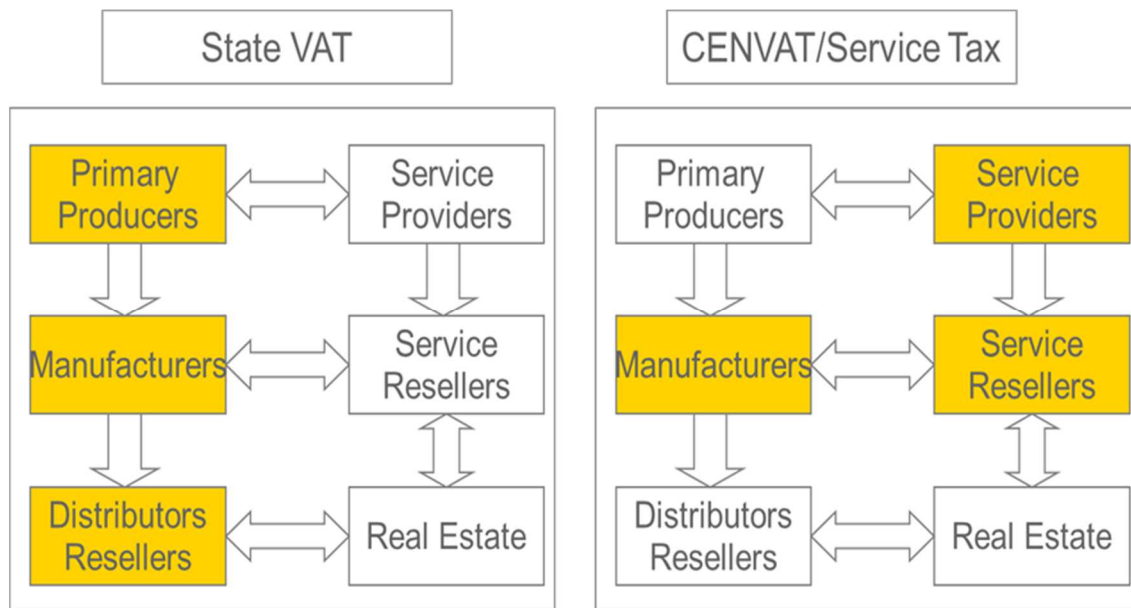
3.6 Inefficiencies in the Indirect Tax System

The important indirect taxes levied by the Union government are customs duties on imports, central excise (CENVAT) on manufacture of goods within the country and service tax on services. The value addition in the post manufacturing stage is excluded from the Centre's tax base.

The principal tax levied by the State Governments is the sales tax or VAT on intra-state sale of goods.

Figure 3.1 presents the broad structure of these taxes:

Figure 3.1: Structure of Indirect Taxes in India



The above table depicts the various segments that the economy is divided into – the primary producers (farmers), the manufacturers and the distributors, the service providers and the real property sector. The coloured boxes depict the sectors within the scope of the State VAT or CENVAT/Service Tax and the white boxes represent areas which are outside the ambit of the State VAT or CENVAT/Service Tax.

There are many gaps within the current arrangement. The State VAT applies to primary producers, manufacturers and distributors and retailers. However, it excludes the service sector and sales of real property. The CENVAT and the service tax are levied on

manufacturers and service providers respectively but the primary producers, distributors, and real property sectors are excluded from their scope.

In the current tax structure, the excluded sectors cannot take credit of the tax charged to them on inputs by their suppliers. The input tax on these services gets added to the cost of the product supplied by them, leading to tax cascading.

Besides the State VAT, the CENVAT and the service tax, a levy that merits particular mention is the Central Sales Tax (CST), a levy on the inter-state sales of goods. CST is levied by the Centre (entry 92A of the Union list) but is administered and retained by the state from where the movement of goods commences. Thus, CST implies taxation according to origin as opposed to destination. This constitutes a serious impediment to the free flow of trade within the country.

Prior to the introduction of State VAT in the year 2005, the indirect tax system in India suffered from several inefficient features and complexities that caused multiple problems including sub-optimal output growth, high costs for the industry, barriers to inter-state trade (and growth of a common market), inter-jurisdictional conflicts and high compliance costs. For instance, on account of problems in administering the tax at retail level, most States had moved the point of levy of their sales taxes to the first point of sale, i.e. on manufacturers and importers of goods. The system of first point taxation resulted in many distortions such as complexities in defining 'manufacture', risk of tax evasion and inequity in the incidence of tax¹.

Further, taxation of inputs and capital goods created a huge cascading impact on the industries. Annex 2 gives details about the treatment of input tax credit on capital goods. High and multiple tax rates coupled with exemptions and concessions further added to the complexities. Also, taxation of inter-State sales and lack of harmony in the States' sales tax systems encouraged harmful inter-State competition and tax evasion.

Moreover, exclusion of services from the tax base narrowed the base and encouraged definitional ambiguities particularly in the case of works contracts consisting of supplies of both goods and services. It also created scope for tax avoidance.

Many initiatives were taken over the years to rationalize the tax structure and minimize the inefficiencies. At the Central level, a Central Value Added Tax (CENVAT) Credit Scheme was introduced, which limited the cascading effect of duty incidence on a number of excisable goods used as inputs / capital goods for manufacture of other excisable goods. The CENVAT rates were rationalized by reducing their multiplicity and replacing many of the specific rates by ad valorem rates based on the maximum retail price (MRP) of the products. Most importantly, the introduction of service tax in the year 1994 and its substantial expansion over the years has widened the tax base considerably.

¹Reform of Domestic Trade Taxes in India: Issues and Options, Study by NIPFP, Team Leader: A. Bagchi (1994)

The replacement of the state sales tax system with a comprehensive State VAT rationalized the tax structure to a large extent. The State VAT eliminated the complexities associated with the application of sales taxes at the first point of sale and lessened the cascading of tax. The consensus reached among the States for uniformity in the VAT rates checked the harmful tax competition among them. However, State VAT rates have changed over the years and now there are considerable differences in the rates across states.

These changes significantly improved the economic efficiency of the tax system, eased tax compliance and yielded enhanced revenues. Even after the tax reforms introduced over the years, the Indian indirect tax system continues to suffer from deficiencies and complexities that call for the next level of tax reforms. Some of these deficiencies are noted below.

Tax at manufacturing level forms a narrow base - CENVAT is levied on goods manufactured or produced in India. The point of manufacturing alone becomes a narrow base for taxation and concentrates the tax burden on only one point of the supply chain. Moreover, the definition of what constitutes 'manufacture', classification uncertainties and determination of the value on which tax is to be levied have been matters of significant dispute². Further, there are leakages from the tax base through various exemptions.

Tax cascading due to partial coverage - Constitutionally, both the Centre and the States are precluded from levying taxes on a comprehensive base of all goods and services at all points in the supply chain. The Centre cannot tax goods beyond the point of manufacturing and the States are not empowered to tax services. The limited tax base has a negative impact on the economic efficiency of tax. Specifically, it leads to tax cascading where the sectors excluded from a given tax are producers of intermediate goods and services, not final consumer goods and services. For instance, at present, many sectors such as oil and gas production and mining, agriculture, wholesale and retail trade, real estate construction, and a range of services remain outside the ambit of the CENVAT and the service tax levied by the Centre. This partial coverage of central and State taxes leads to significant tax cascading as the exempt sectors are not allowed to claim any credit.

Similarly, under the State VAT, no credits are allowed for the inputs of the exempt sectors, which include the entire service sector, real property sector, agriculture, oil and gas production and mining.

The Central Sales Tax (CST) on inter-state sales, collected by the origin state and for which no credit is allowed by any level of government also contributes significantly to the tax cascading.

Administrative complexities – The tax design and administrative systems at both central and state levels remain complex and are subject to disputes and court challenges. The existence of exemptions and multiple rates, and the irrational structure of the levies

² A detailed discussion on the complexities is given in the NIPFP Study on Reform of Domestic Trade Taxes in India conducted under the leadership of A. Bagchi

give rise to many complexities. For instance, the starting base for the CENVAT is narrow, and is being further eroded by a variety of area-specific, and conditional and unconditional exemptions.

At the State VAT level, numerous complexities exist, primarily relating to classification of goods in different tax rate schedules. For instance, the basic necessities could be exempted from tax, taxable at 4-5%, or taxable at the standard rate of 12.5% or higher. Another source of complexity under the State VAT is determining whether a particular transaction constitutes a sale of goods or of services. There has been considerable litigation, for instance, whether software products, intangibles such as the right to distribute/exhibit movies, time slots for broadcasting advertisements, or even telecommunication are a supply of goods or services.

The tax administration leaves a lot to be desired. The current administrative infrastructure is archaic at both central and state levels. The process for resolution of disputes is slow and expensive. At the same time, the systems suffer from substantial compliance gaps, except in the highly organized sectors of the economy. This not only increases the costs of compliance, but also undermines revenue collection.

A comprehensive and well-designed goods and services tax can overcome most of these deficiencies. This is discussed in Chapter 4.

3.7 Domestic Indirect Taxes: Some Textile-specific Issues

Based on interactions with the relevant stakeholders including the Federation of Indian Art Silk Weaving Industry (FIASWI), which represents a significant segment of the powerloom industry, some pertinent issues in the current indirect tax treatment of the textiles industry may be highlighted:

▶ Break in Input tax credit chain

The textiles industry comprises of both regular and composition taxpayers, with a large proportion of the industry being in the composition segment. Numerous transactions in the textiles industry flow from the unorganized to the organized sector and vice versa.

In instances where regular taxpayers purchase goods from composition taxpayers, they are ineligible for any input tax credit, thereby breaking the credit chain. Any input taxes paid on previous transactions in the supply chain is included in the cost of the product, seriously affecting the competitiveness of textile exports by merchant exporters.

▶ Small business threshold and compliance cost

Composition taxpayers are reluctant to join the regular CENVAT credit chain, since it increases their compliance cost, given that they have to engage professionals for meeting their tax obligations.

Historically, due to the high administrative cost of administering sales tax on a large population of powerloom units, the state governments had entered into a tax rental agreement with the Central government, whereby the Central government used to levy an Additional Excise Duty (AED) on all textile products after the grey fabric stage, which was then distributed to the State governments based on Finance Commission recommendations.

After the tax rental agreement under the Additional Excise Duty was discontinued, attempts to levy CENVAT on all powerloom units without a threshold limit resulted in a strike by powerloom units, which eventually led the Central government to offer an optional excise duty payment route.

Given the above background, under the GST, the threshold level for small businesses is critical. This should be decided judiciously after considering the pattern of manufacturing and trading in the decentralized sector. At the same time it is important to minimize the compliance cost for taxpayers through use of appropriate IT tools and taxpayer communication and services.

▶ Differential treatment of Job Work under CENVAT and State VAT

Currently indirect tax treatment of units performing job work is different between CENVAT and State VAT. For the purpose of CENVAT, job work units are treated like any other manufacturing unit with job workers paying CENVAT on processed fabrics and getting a credit of excise duty paid on their inputs i.e. grey fabrics.

Unlike the CENVAT procedure, the State VAT treats job workers under the Works Contract category, where job workers pay tax on the total value of goods used in processing the fabric like dyes etc. including gross profit. This leads to a difference in tax base with the CENVAT tax base being more than the State VAT tax base.

Under a uniform GST, with a common return for CGST and SGST, this differential treatment will be removed, since the tax base will be uniform based on value addition at each stage of the supply chain.

▶ Exempt sectors

Fuel (Petroleum products, Gas, Electricity etc.) comprises 35-40% of the cost for synthetic textiles. Given that current GST discussions do not indicate inclusion of Petroleum products and electricity under GST, the competitiveness of the synthetic textile industry with respect to other textile sectors in India and globally will be affected adversely.

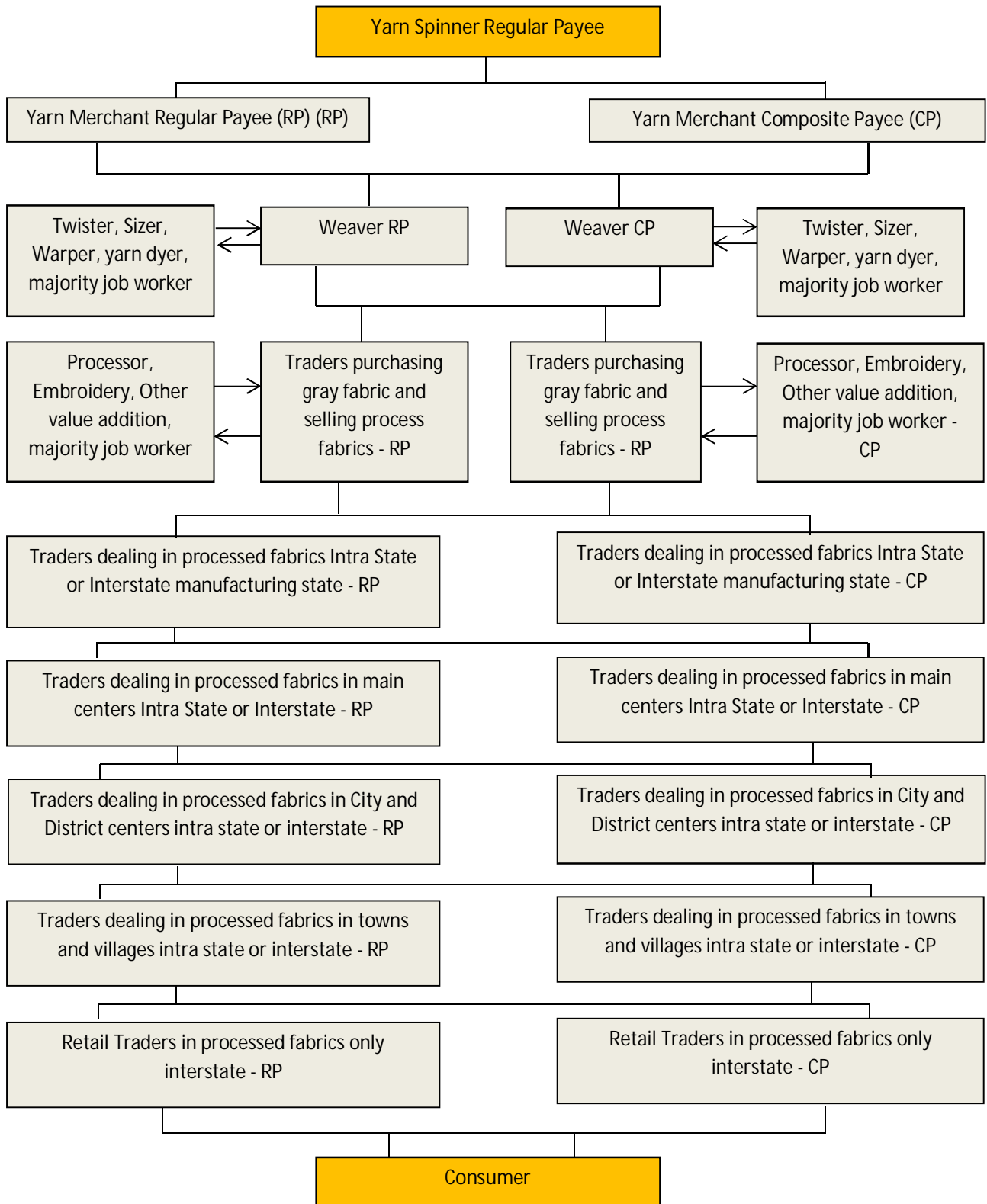
To overcome this bottleneck it is recommended that all demerit goods, including fuel inputs such as Diesel, Coal etc. should be subject to a non-rebatable supplementary duty plus the GST. The GST component could be rebated to ensure seamless pass through of the tax to the final consumer.

▶ Inclusion of all other taxes into the GST

The textiles supply chain is replete with instances where inputs and outputs move across state-borders multiples times to reach the final consumer. In this process, Octroi and Entry tax in lieu of Octroi are a significant bottleneck, which is not rebated/partially rebated in most states, and therefore forms a part of the cost base of the final product. As a result Indian synthetic textiles become uncompetitive against imports from China and other South-East Asian nations, where such distortionary taxes are not applicable.

It is therefore desirable to subsume all such taxes, including Octroi, Entry tax and Local Body taxes, into the GST to ensure that there is no tax cascading at any stage of manufacturing or distribution and exports are indeed zero-rated and competitive in world markets.

Figure 3.2: Typical Tax Supply Chain in the Textile Industry



Legend:

RP - Regular Payee

CP - Composite Payee

Source: Federation of Indian Art Silk Weaving Industry

Figure 3.2 depicts a typical tax supply chain in the textile industry. The Yarn spinning unit at the start of the supply chain is mostly a large scale unit which is a regular registered taxpayer (RP). However, after the spinning stage; the weaving, processing and trading stages comprise of a mix of Regular Payers (RP) and Composition taxpayers (CP). Intermediate inputs may move through this supply chain in the following ways:

- ▶ Through a chain of RPs, in which instance all input taxes will be credited through the production and distribution chain and the burden of tax will be incident on the final consumer; or
- ▶ Move across from RPs to CPs and vice versa through the supply chain, in which instance input taxes will be blocked at all those stages where CPs purchase tax paid inputs from RPs but are ineligible for input tax credit and where RPs purchase inputs from CPs, where they are unable to claim credit of any blocked input taxes in the previous stage. This results in significant cascading of taxes through the supply chain.

The above instance clearly demonstrates the pitfalls of a full/partial exemption or a Composition scheme, where blocked input taxes can result in increased costs for producers and higher prices for the final consumer.

Conversely, a clean GST with no exemption and/or composition scheme, results in a significant expansion of the tax base, which in turn leads to reduction in the Revenue Neutral Rates (RNR) for GST. Any apprehensions/misgivings related to complexities in compliance procedures can be dealt effectively through a simple design and administration of the GST.

The main difficulties faced by the textile sector in the current domestic indirect tax regime may be summarized as below:

- ▶ Classification disputes
 - ▶ Fabrics vs. garments, e.g. should sarees be treated as fabrics or as readymade garments
- ▶ Fibre neutrality
 - ▶ Cotton fibre vs. manmade fibres. Cotton fibre treated favorably as compared to Manmade fibres
- ▶ Effective tax rates vary by degree of integration
 - ▶ Power looms vs. Composite mills. Effective tax rates for composite mills higher than that of power looms discouraging integration of production adversely affecting efficiency

The current administrative infrastructure is archaic at both central and state levels. The process for resolution of disputes is slow and expensive. At the same time, the systems suffer from substantial compliance gaps, except in the highly organized sectors of the economy. This not only increases the costs of compliance, but also undermines revenue collection. The key concerns of the textile sector may be summarized as below:

- ▶ Break in input tax credit chain
- ▶ Small Business Threshold
- ▶ Compliance cost
- ▶ Uniform tax treatment under CGST and SGST – e.g. presently Job Workers are treated differentially under CENVAT and State VAT

- ▶ Textile sector inputs which may remain exempt – Petroleum products, Electricity, Real estate
- ▶ Whether all taxes (e.g. Octroi, Entry tax, Electricity duty etc.) will be subsumed under the GST, which will effectively lead to zero cascading and make Indian exports truly competitive globally

A comprehensive and well-designed goods and services tax can overcome most of these deficiencies. This is discussed in Chapter 4.

Chapter 4: Emerging Contours of GST

4.1 Introduction

As discussed in Chapter 3, in spite of a long sequence of reforms of the domestic indirect taxes, various problems remain. The system of VAT is at present segmented between Cenvat, State-VAT, Central Sales tax, Entry tax, Service tax, and a variety of other taxes at the state level. In all cases, multiple tax rates and a variety of exemptions apply and cascading continues across different taxes. Several problems continue in the system of taxation of goods and services as summarized below.

1. In the case of Cenvat, issues relating to definition of manufacturing and methodology of valuation remain causing difficulties in implementation of the tax.
2. The problem of multiple rates remains although the tax rate structure is simpler than what it used to be. This leads to various classification disputes.
3. In the case of service taxation, problems relate to distinguishing between a good and a service. The distinction between the two is often blurred.
4. Exclusion of services from the tax base of the states potentially erodes their tax-buoyancy in a growing economy that is service-sector centric.
5. Cascading has not been fully eliminated as there is cross cascading between State VAT and Cenvat and service tax.
6. The Central sales tax continues to cause artificial inter-state tax borders. It constrains achieving the objective of a destination based system of taxation of goods and services.

These problems can be resolved by a comprehensive goods and services tax (GST). Many of these problems can be addressed by extending the scope of taxation to services to the states and the scope of taxation of goods beyond manufacturing up to the retail stage to the centre. Considerable discussion has already taken place as to a suitable design and administrative framework for GST. While, it has not been possible to resolve all the differences, significant progress has been made and the main contours of the GST appear to be emerging.

Taking account of the latest developments, the present position is that the central government has come out with a revised draft of the constitution amendment bill (2013) after receiving the report of the Parliamentary Standing Committee on the earlier constitution amendment bill (2011). The revised constitution amendment bill is presently being deliberated upon by the Empowered Committee (EC) of the State Finance Ministers. Based on the discussions at the Empowered Committee and the deliberations of the central government, certain contours of the GST have emerged clearly while there are some critical aspects on which decisions will have to be taken by the proposed GST Council.

4.2 Design of GST: Basic Features

GST will be a concurrent GST where the central and state governments will share a common tax base consisting of the value added of goods and services in the production and sale of goods and services.

1. The GST will have two components: one levied by the Centre (CGST) and the other levied by the States (SGST). The basic features of law such as chargeability, definition of taxable event and taxable person, measure of levy including valuation provisions, basis of classification etc. should be uniform across these statutes as far as practicable.
2. The CGST and SGST would be applicable to all supply of goods and services made for a consideration except for the exempted goods and services, goods which are outside the purview of GST and the transactions which are below the prescribed threshold limits.
3. The CGST and SGST are to be paid to the accounts of the Centre and the States separately. Taxes paid against the CGST and SGST will get input tax credit (ITC) within the CGST and SGST chains respectively but cross utilization of ITC between CGST and SGST would not be allowed.
4. The administration of the CGST will be with the centre and that of SGST with the States.
5. The following Central Taxes are to be subsumed under the GST: (i) Central Excise Duty, (ii) Additional Excise Duties, (iii) Excise Duty levied under the Medicinal and Toiletries Preparation Act, (iv) Service Tax, (v) Additional Customs Duty, commonly known as Countervailing Duty (CVD), (vi) Special Additional Duty of Customs (SAD), (vii) Surcharges, and (viii) Cesses.
6. The following State taxes and levies are to be subsumed under GST: (i) VAT / sales tax, (ii) entertainment tax (unless it is levied by the local bodies, (iii) luxury tax, (iv) taxes on lottery, betting and gambling, (v) State cesses and surcharges in so far as they relate to supply of goods and services, and (vi) entry tax not in lieu of Octroi.

The treatment of alcoholic beverages and tobacco under the GST is still not clear. As far as petroleum products are concerned, i.e. crude, motor spirit (including ATF) and HSD are to be kept outside GST. Sales Tax could continue to be levied by the States on these products with prevailing floor rate. Similarly, Centre could also continue its levies.

In this model, the Centre would levy an Integrated Goods and Services Tax (IGST) which would be CGST plus SGST on all inter-State transactions of taxable goods and services with appropriate provision for consignment or stock transfer of goods and services. The inter-state seller will pay IGST on value addition after adjusting available credit of IGST, CGST, and SGST on purchases. The exporting state will transfer to the Centre the credit of SGST used in payment of IGST. The importing dealer will claim credit of IGST while discharging his output tax liability in his own State. The Centre will transfer to the importing State the credit of IGST used in payment of SGST. The relevant information will also be submitted to the central agency which will act as a clearing house mechanism, verify the claims and inform the respective governments in respect of transfer of the funds.

4.3 Main Features of the Revised Constitution Amendment Bill

There is still some uncertainty as to the form of GST that will eventually be implemented. The Empowered Committee of State Finance ministers is presently considering the revised draft of the constitution amendment bill (2013) prepared by the central government after receiving the report of Parliamentary Standing Committee on Finance on the earlier constitution amendment bill (2011) regarding GST. The main features of the revised constitution amendment bill are summarized below.

Parliament and Legislature of every State will have the power to make laws with respect to the goods and services tax. Parliament will have exclusive right to make laws with respect to goods and services tax where the supply of goods or services or both take place in the course of inter-state trade or commerce; the proceeds of the goods and services tax on such inter-state supply of goods or services are to be apportioned between the Union and the States.

GST collected by the Government of India is to be shared with the States under article 270 under the recommendations of the Finance Commission.

A Goods and Service Tax Council (GST Council) will be constituted under article 279 A. The GST Council will decide on the following issues:

1. Taxes, cesses and surcharges levied by the centre, the states and the local bodies that are to be subsumed in GST;
2. The goods and services that may be exempted from GST;
3. The threshold limit of turnover below which goods and services may be exempted from GST;
4. The rates including floor rates and bands for GST;
5. Any special rate or rates for a specified period to raise additional revenue during any natural calamity or disaster;
6. Special provisions with respect to the States of Arunachal Pradesh, Assam, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura;
7. Any other matter relating to the GST as the Council may decide.

The GST Council is to be guided by the need for a harmonized structure of the goods and services tax and for the development of a harmonized national market for goods and services.

One half of the total number of members will constitute the quorum. A majority rule has been substituted instead of the earlier provision for consensus. A decision can be taken by a majority of weighted votes of three-fourth of the members present and voting with the central government carrying a weight of one-third and State governments together carrying a vote of two-thirds.

The provision of a dispute resolution authority in the 2011 constitution amendment bill has been done away with. There is a provision for constituting advisory committees for examining specific disputes or issues.

The central government by modification of entry 84 of the Union List of the seventh schedule to the constitution will have power to levy excise duty on the following six goods/ groups of goods:

1. Petroleum crude
2. High speed diesel
3. Motor spirit (commonly known as petrol)
4. Natural gas;
5. Aviation turbine fuel; and
6. Tobacco and tobacco products.

State governments will have power to levy sales tax by modification of entry 54 of the State List of the seventh schedule to the constitution:

Taxes on the sale (not including sale in the course of inter-state trade or commerce) of

1. Petroleum crude,
2. High Speed Diesel;
3. Natural Gas;
4. Motor spirit (commonly known as petrol)
5. Aviation turbine fuel
6. Alcoholic liquor for human consumption

Entry tax will be abolished by deleting entry 52 of the State List of the Seventh Schedule to the Constitution. The reference to 'purchase' in addition to sale in the earlier provision under item 54 is also deleted. Entry 62 of the State list is also to be modified so that taxes on entertainment and amusement are to be permitted only if these are levied and collected by local bodies. Since Parliament and each State legislature will have the power to levy the GST, each will have to frame its by-laws and rules. These will have to be guided by the need for bringing in a 'harmonized' structure of taxation.

A number of key issues have been left for the GST Council to decide. This includes determination of the CGST, IGST, and SGST rates in terms of the floor rates and the width of the band. Whether the bands can be state-specific and specific to goods and services are also aspects that remain open-ended. Similarly whether ITC is to be allowed on the floor rates or rates including the bands need to be deliberated upon. The revenue implications and determination of revenue neutral rates also depend on whether GST is applied to items under entry 84 of the Union List and entry 54 of the State List as their inclusion or exclusion affects the extent of cascading.

States have continuing concerns even with the amended constitution amendment bill. For example, the Government of Gujarat (GoG), in its memorandum to the Fourteenth Finance Commission, has expressed the following main concerns with the GST design and framework as implicit in the revised constitution amendment bill (2013).

First, the assigned role of GST council is likely to result in a situation where the Executive body of State Finance Ministers would be performing the functions of the State legislature and Parliament. The GST council will become a "Super Legislature". The supremacy of the legislature in taxation matters would be lost to an executive agency. GoG in its presentation to the Standing Committee on Parliament observed that it is pertinent to recall the words of James Otis "Taxation without representation is tyranny". It expressed the concern that Harmonised tax structure should not become the premise for taking away discretion of elected Governments.

Second, GST will restrict the flexibility and potential available to the States to raise resources and will result in huge revenue losses to the State by restricting powers of taxation and complete erosion of fiscal autonomy. The conflict arising as a result of the concurrent jurisdiction on GST, along with the proposal to have a harmonious tax structure, would lead inevitably to the loss of the flexibility and discretion in taxation available to the States.

Third, the Amendment Bill provides for keeping Tobacco and Tobacco products as a specific entry "84" in List I of the seventh schedule enabling the Union Government to levy excise duty over and above GST. Such power of levying VAT has been denied to States. The tobacco and tobacco products should be available for State levy of sales tax in addition to SGST.

Fourth, there is also the apprehension that at the time of transition the central government will benefit relatively more than the States as a result of (a) CGST rate

being higher than actual RNR for the centre; (b) extensive reduction in the number of goods under the common exempted list, and (c) lowering of threshold of dealers for the Centre.

4.4 Key Unsettled Aspects of GST

Under the proposed constitutional amendment, the GST Council will have to decide on a number of key aspects of GST. The specific decisions taken in this regard will have significant implications for the central and state tax revenues and the overall growth of the economy. These will also have significant implications for the textile sector.

4.4.1 CGST and SGST Structure and Rates

The GST rate-structure may be a combination of exempted goods, goods subjected to a lower rate, goods subjected to the standard rate, goods subjected to standard rate plus band rate, and zero-rating of exports. The rate variation may apply to both CGST and SGST. In both cases, bands may be applied.

In India, the debate on revenue implications has focused on determining a 'revenue neutral rate' or a 'structure of revenue neutral rates', which would generate the same amount of revenues as presently under the taxes that are to be replaced by the GST. With such a revenue neutral rate, two additional questions are: a division of the overall rate between the centre and states; and if for the states taken together, the rate is revenue neutral, then some states are bound to lose while others will gain. If so, how to compensate the losing states for their losses and for how long can such compensation continue.

Preliminary estimates suggest that if CGST and single SGST rates are set equal, the centre will be a net gainer given the present level of revenues of the taxes that are to be merged in GST.

Table 4.1: GST Rate Structure

Empowered Committee (Earlier)	13th Finance Commission	Current Discussions
SGST For Goods 2 Rate Structure Lower rate: 4-5 percent Core rate: 8-10 percent Services: one rate 8-10 percent	CGST: 5 percent SGST: 7 percent Stated as the target.	CGST (goods and services): 8 Percent SGST (goods): Lower 6 percent SGST (goods): Higher 10 percent SGST (services): 8 percent Plus bands in each case.

Source: Compiled by project team

Table 4.1 provides a summary of the proposed GST rate structure earlier by the EC, the Thirteenth Finance Commission, and what appears to be emerging out of current discussions. This matter is yet to be finalized and a final call can be taken by the GST

Council once the constitutional amendment bill is passed and such a council is established.

We have considered the lower rate for goods at 6% both for CGST and SGST giving an overall rate of GST at 12% for the present study.

4.4.2 Inter-State Transactions

In the Empowered Committee model, the Centre would levy Integrated Goods and Services Tax (IGST) which would be CGST plus SGST on all inter-State transactions of taxable goods and services with appropriate provision for consignment or stock transfer of goods and services. The inter-State seller will pay IGST on value addition after adjusting available credit of IGST, CGST, and SGST on purchases. The exporting state will transfer to the Centre the credit of SGST used in payment of IGST. The importing dealer will claim credit of IGST while discharging his output tax liability in his own State. The Centre will transfer to the importing State the credit of IGST used in payment of SGST. The relevant information will also be submitted to the Central Agency which will act as a clearing house mechanism, verify the claims and inform the respective governments to transfer the funds. There is now some rethinking on this matter. IGST involves that payments would first go to the central government. States are suggesting a system of zero-rating for inter-state sales instead of IGST.

4.4.3 Threshold Limits

A uniform State GST threshold across States is desirable. A threshold of gross annual turnover of Rs.10 lakh both for goods and services for all the States and Union Territories may be adopted with adequate compensation for the States (particularly, the States in North-Eastern Region and Special Category States) where lower threshold had prevailed in the VAT regime. The threshold for Central GST for services may also be appropriately high. Even now there is a separate threshold of services (Rs. 10 lakh) and goods (Rs. 1.5 crore) in the Service Tax and CENVAT.

4.4.4 Exempted Goods and Services

Presently, about 100 items are exempt in the State VAT and about 250 items are exempt in CENVAT. The number of items under this exempt list differs from state to state. A common and smaller list would reduce the number of exempted items far more for the centre as compared to the States. Similarly, if the threshold limit for centre is reduced from Rs. 1.5 crore to Rs. 10 lakh, the central government will have a much larger number of additional dealers (about 30 lakh dealers) thereby resulting in revenue gains to the centre.

4.4.5 Treatment of Demerit Goods and Petroleum Products

The constitution amendment bill has placed selected demerit goods (alcoholic beverages and tobacco and tobacco products) and petroleum goods under entry 84 of the Union List and Entry 54 of the State List such that they can be included or excluded from GST. If included, they can still be subjected to excise duty by the central government and sales tax by the State government. While the excise and sales tax components may be non-rebatable, the GST component may be rebatable at different stages of value added. If these are excluded from GST, these will be subjected to excise and sales taxes, which may be non-rebatable.

Since some textile products use petroleum products as inputs, the inclusion or exclusion will have a significant impact on the relevant textile products.

The impact on State revenues will depend on (a) the taxes to be merged (b) SGST rate and its structure, whether single or two rates, and the width of the bands (c) the additional tax base due to the inclusion of services (d) and the contribution of CST.

The additional revenue base coming from services is likely to be limited. Public administration and defence, education, medical and health services contribute 10.5% share in GDP and these will remain exempt under GST. Supply of electricity, gas, hotels and restaurants, road transport, ownership of dwelling units, renting of machinery, recreation and entertainment, beauty treatment contribute about 29% share in GDP and are being taxed already by the States. Out of the remaining services, construction, banking and insurance, IT and telecom are the only major service activities which can be covered under GST. Out of this, construction sector is already taxed by the States. Except telecom and IT, others are exempt under GST. Telecom is the only sector which is not being covered at present by the States.

Revenue implications of GST can be considered in two parts: (a) at the time of transition and (b) longer term prospects in terms of revenue buoyancy of GST with respect to GDP at market prices.

At the time of transition, the actual RNR rates and the CGST and SGST rates need to be compared to ascertain whether either the centre or the states considered together are net gainers or losers. These calculations will depend on the rate structure, permitted width of the band(s) and whether items under Entry 84 of the Union List and entry 54 of the State List are included or excluded.

As far as the central finances are concerned, the tax base would be expanded to capture value added margin from beyond manufacturing covering wholesale and retail margins. The expected impact on central revenues would be positive on this account. Further, there would be base broadening for the centre as the list of exempted goods is likely to be narrowed far more for the centre than the States. Some necessities including food products may be captured in the base with a positive revenue impact. At the same time since there would be less cascading in GST, there may be a negative impact but this would be common for the centre and the States.

In regard to the impact on State finances, a positive impact will come from the inclusion of services in the tax base. There would be some additional items once the number of exempted goods is reduced. This list would however be smaller for the States as compared to the centre. If some low rate items under VAT are put into higher rate items list under GST, there may be some positive revenue impact.

4.5 GST and the Textile Sector: Some Specific Aspects

Under GST, the core functions relating to the dealer-administration interface such as registration, returns, payments, and refunds will be centralized. This will lead to significant simplification of compliance as it virtually eliminates interface between taxpayers and tax administration for compliance related activities. The role of state governments will be largely limited to audit and assessment.

An important issue particularly in the context of textiles would be to determine the threshold. There will be a uniform threshold for CGST and SGST. It is likely to be much

lower than the current SSI threshold of Rs. 1.5 cr under CENVAT and higher than the most common State VAT threshold of Rs.10 lakhs. Present discussions indicate that the threshold is likely to be around Rs. 25 lakh. The threshold could be lower for hilly States.

A low small business threshold is likely to discourage powerloom owners from fragmenting their units to stay under the small business threshold. To facilitate integration of small powerloom units into the GST, the Ministry of Textiles in cooperation with Ministry of Finance and respective State governments could consider providing shared tax compliance services to such units in prominent clusters to minimize compliance costs.

Some of the outstanding issues in the implementation of GST that will have significant implications for the textile sector relate to whether there will be:

- ▶ Single/dual control of dealers by Central and State governments;
- ▶ Single/Multiple tax rates; and
- ▶ Degree of cross-matching of data – invoice level matching vs. dealer level matching

Chapter 5: Estimation of Revenue Neutral Rates

5.1 Introduction

Revenue neutral rates may be calculated for the central government and state governments, separately and jointly. In this exercise, the effort is to find out the GST rate, composed of the CGST and SGST rates, which would raise the same amount of revenue as is presently being raised under the taxes that are to be merged into the GST.

Certain important features of taxation of textile industry may be noted at this stage. State governments have not levied VAT on textile outputs in general after the arrangement under additional excise duty in lieu of sales tax was discontinued. These sectors continue to be exempt. But if any input taxes are paid, these may be blocked and should be taken into account in calculating the RNR. Furthermore, a major difficulty is that the state governments do not compile data according to industries or products. As such there is no data with respect to State VAT, central sales tax, or entry tax paid on textile products with respect to which the RNR can be calculated. Textile production requires petroleum products as inputs in certain product lines where, for example, man-made fibres are used. Taxes on petroleum products may remain un-rebated both in central and state tax regimes. As per present discussions in the empowered committee of state finance ministers, this situation might continue even when GST comes in. In textile production, a number of services are also used as inputs. At present, services are being taxed only by the centre. Most service tax on service inputs gets rebated against Cenvat liabilities of the textile producers. When GST comes in, services will also be taxed by the States. However, these would get rebated at later stages against CGST and SGST liabilities of the textile dealers and should not make a material difference.

Given the importance of blocked input taxes, the use of the input-output table, the latest version of which relates to 2007-08, is an important component of the methodology used here. This permits a study of nine textile segments where textile outputs are involved. These nine segments are indicated below:

- ▶ Khadi and handlooms
- ▶ Cotton textiles
- ▶ Woollen textiles
- ▶ Silk textiles
- ▶ Art silk and synthetic fibre textiles
- ▶ Jute, hemp, and mesta textiles
- ▶ Carpet weaving
- ▶ Ready-made garments
- ▶ Miscellaneous textile products

The RNR calculations are done with reference to 2011-12 data.

5.2 Segment-wise Input Structure of Textile Products

Textile products are produced out of two types of inputs: textile inputs and non-textile inputs. The latter can be divided into non-textile goods and services. Thus, the broad input structure may be divided into three parts: textile inputs, non-textile inputs (goods) and non-textile inputs (services). The relative shares of each are given in Table 5.1.

Table 5.1: Inputs to Textile Products: Relative Shares of Textile and non-Textile Inputs

	46	47	48	49	50	51	52	53	54	72
Structure of Inputs	Khadi, cotton textiles (handlo oms)	Cotton textiles	Woollen textiles	Silk textiles	Art silk, synth. fibre textiles	Jute, hemp, mesta textiles	Carpet weaving	RMG	Misc. textile prdts	Synth fibres, resin
Textile inputs	46.3	52.1	45.1	38.7	40.6	38.4	42.2	47.1	41.3	14.1
Non-textile inputs (goods)	16.2	11.9	19.5	25.2	28.4	19.5	19.9	16.5	23.4	58.4
Non-textile inputs (services)	36.5	34.2	33.9	35.0	29.7	39.6	36.7	35.3	33.6	22.4
Total Non-textile inputs	52.7	46.1	53.4	60.2	58.1	59.0	56.6	51.9	57.0	80.7
Non-textile inputs (not shown)	1.0	1.8	1.4	1.0	1.3	2.5	1.2	1.0	1.7	5.2
Total	100	100	100	100	100	100	100	100	100	100

Source: Input-Output Table, Commodity by Commodity Matrix, 2007-08, CSO, MOSPI, Government of India (2013)

Details of relative shares of inputs from the textile sector to produce textile sector outputs are shown in Table 5.2. Textile products are produced out of textile inputs in different mixes and blends and at different stages of value added. Textile inputs account for a share of total inputs ranging from 38.4% percent in the case of Jute, hemp and Mesta textiles to 52.1 percent in the case of cotton textiles.

Table 5.2: Textile Inputs for Textile Products: Relative Share of Inputs in Total Inputs

(percent)

Product	Khadi, cotton textiles (handlooms)	Cotton textiles	Woollen textiles	Silk textiles	Art silk, synthetic fibre textiles	Jute, hemp, mesta textiles	Carpet weav.	RMG	Misc. textile prdts
Jute	0.02	0.02	0.01	0.06	0.51	22.59	3.74	0.05	0.13
Cotton	10.91	28.36	10.74	0.79	5.62	1.21	0.40	1.08	7.61
Khadi, cotton textiles(handlooms)	10.87	1.11	0.35	1.38	0.33	0.27	1.08	3.03	2.04
Cotton textiles	15.37	6.63	2.58	5.82	2.19	1.22	4.16	16.55	7.40
Woollen textiles	0.02	0.10	17.85	0.50	0.62	3.45	7.69	1.20	0.72
Silk textiles	0.00	0.23	0.20	11.47	0.91	0.49	0.46	1.33	0.42
Art silk, synthetic fibre textiles	8.73	7.81	6.10	11.70	15.38	3.79	10.73	10.26	10.75
Jute, hemp, mesta textiles	0.08	0.24	1.11	0.37	0.29	3.59	3.26	0.59	0.58
Carpet weaving	0.00	0.02	0.25	0.01	0.01	0.00	0.01	0.01	0.01
Readymade garments	0.01	4.32	4.29	0.51	1.02	0.35	2.30	3.12	1.83
Miscellaneous textile products	0.14	2.58	1.43	3.88	2.54	1.04	6.61	6.93	4.71
Synthetic fibres, resin	0.14	0.68	0.21	2.22	11.22	0.41	1.73	2.96	5.14
Sum	46.28	52.08	45.12	38.73	40.64	38.41	42.17	47.10	41.34

Source: Input-Output Table, Commodity by Commodity Matrix, 2007-08, CSO, MOSPI, Government of India (2013)

The non-textile inputs consist of non-textile (goods) and non-textile (services). The relative share of major items in segment-wise total inputs are shown in Table 5.3 and 5.4.

Table 5.3: Relative Share of Non-textile Inputs (Goods)

(Percent)

Sector/ Code	Commodity	46	47	48	49	50	51	52	53	54
		Khadi, cotton txtls (handl ooms)	Cott. txtls	Wool. txtls	Silk txtls	Art silk, synt fibre txtls	Jute, hemp, mesta textile s	Carp. Weav	RMG	Misc. txtl prdts
	Share of non-textile inputs	53.7	47.9	54.9	61.3	59.4	61.6	57.8	52.9	58.7
20	Other crops	0.0	0.0	0.0	0.2	0.0	0.2	0.2	0.1	0.2
24	Other liv.st. prod.	0.0	0.0	7.5	0.9	0.1	0.0	0.3	0.2	0.8
25	Forestry and logging	0.0	0.0	0.0	0.1	0.0	0.2	0.1	0.0	0.2
27	Coal and lignite	0.2	0.2	0.2	0.1	0.5	0.8	0.2	0.1	0.2
28	Natural gas	0.0	0.0	0.0	0.8	0.2	0.1	0.6	0.2	1.0
37	Other non-metallic minerals	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0
43	Miscellaneous food products	0.2	0.5	0.2	0.0	0.2	0.1	0.0	0.1	0.2
55	Furniture and fixtures-wooden	0.0	0.0	0.0	0.0	0.5	0.1	0.0	0.1	0.1
56	Wood and wood products	0.5	0.2	0.1	0.2	0.3	0.2	0.2	0.4	0.3
57	Paper, paper prods. & newsprint	0.7	0.5	0.3	0.4	1.4	1.3	0.7	0.9	0.7
60	Leather and leather products	0.0	0.2	0.5	1.4	0.1	0.3	1.5	1.1	2.7
61	Rubber products	0.0	0.0	0.0	0.1	0.1	0.1	0.5	0.2	0.3
62	Plastic products	1.3	0.3	0.3	0.8	3.1	0.3	0.5	1.3	1.3
63	Petroleum products	1.9	1.5	1.4	1.5	2.6	0.7	0.8	1.0	1.3
65	Inorganic heavy chemicals	0.5	0.7	0.4	0.7	4.3	0.7	0.5	0.4	1.0
66	Organic heavy chemicals	0.2	0.4	0.1	9.1	7.0	0.9	0.2	0.5	1.3
69	Paints, varnishes and lacquers	3.1	0.7	0.4	0.2	0.8	0.7	0.3	0.3	0.6
71	Soaps, cosmetics & glycerine	1.0	0.0	0.0	0.2	0.1	0.0	0.2	0.3	0.3
73	Other chemicals	0.1	0.2	0.4	0.5	1.9	1.7	0.6	1.6	0.9
76	Other non-metallic mineral prods.	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0
82	Miscellaneous metal products	0.0	0.0	0.0	0.8	0.1	0.6	0.3	0.3	0.4
84	Industrial machinery(F & T)	0.5	0.5	2.6	0.9	0.5	1.1	2.4	1.6	1.4
86	Machine tools	0.0	0.0	0.1	1.0	0.1	0.3	2.7	0.8	1.4
93	Other electrical Machinery	0.0	0.0	0.0	0.1	0.0	0.0	0.1	0.1	0.2
94	Electronic equipment(incl.TV)	0.0	0.0	0.0	0.2	0.0	0.0	0.1	0.1	0.2
105	Miscellaneous manufacturing	0.0	0.1	0.1	0.5	0.2	0.1	2.2	0.7	0.5
106	Construction	0.5	1.1	0.8	3.0	0.9	1.3	2.4	3.1	3.7
107	Electricity	5.5	4.7	4.0	1.7	3.4	7.1	2.2	1.1	2.5
	Sum of Non-textile Inputs (Goods)	16.2	11.9	19.5	25.2	28.4	19.5	19.9	16.5	23.4

Source: Input-Output Table, Commodity by Commodity Matrix, 2007-08, CSO, MOSPI, Government of India (2013)

Electricity, a variety of chemicals, paints and varnishes, and petroleum products are all used as inputs in different textile products. Their relative share in total inputs ranges from 11.9 percent (Cotton textiles) to 58.4 percent (synthetic fibres) in different textile segments.

Table 5.4: Relative Share of Non-textile Sector (Services)

		(Percent)								
Services	Commodity	46	47	48	49	50	51	52	53	54
		Khadi, cotton txtls (handloom ms)	Cott. txtls	Wool. Txtls	Silk txtls	Art silk, synt fibre txtls	Jute, hemp, mesta txtls	Carp. Weav	RMG	Misc. txtls prdt
109	Railway transport services	0.3	0.1	0.1	0.1	0.2	0.3	0.2	0.4	0.2
110	Land transport including via pipeline	9.0	13.4	11.4	6.8	6.8	6.3	7.6	6.2	7.4
112	Air transport	0.5	0.1	0.2	0.2	0.1	0.2	0.1	0.1	0.1
115	Communication	0.2	0.3	0.6	0.6	0.2	0.4	0.6	1.2	0.6
116	Trade	19.4	10.6	14.0	14.4	14.8	21.8	16.4	16.4	14.1
118	Banking	2.2	1.8	2.9	3.9	2.2	3.1	3.6	2.8	1.9
119	Insurance	1.6	1.3	0.7	2.5	1.3	0.6	1.3	1.8	1.2
123	Business services	0.4	0.6	0.5	0.8	1.9	1.0	0.7	1.6	1.2
124	Computer & related activities	1.0	0.2	0.6	1.1	0.3	1.1	0.4	0.6	0.5
125	Legal services	0.2	0.0	0.2	0.3	0.1	0.3	0.2	0.2	0.1
127	Renting of machinery & equipment	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
128	O.com, social & personal services	0.1	5.5	2.1	3.3	1.4	0.9	2.8	3.8	6.0
129	Other services	1.7	0.3	0.6	0.9	0.4	3.5	2.9	0.4	0.3
	Sum of Non-textile Inputs (Services)	36.5	34.2	33.9	35.0	29.7	39.6	36.7	35.3	33.6

Source: Input-Output Table, Commodity by Commodity Matrix, 2007-08, CSO, MOSPI, Government of India (2013)

Transport by rail and road and trade are common service inputs in all the segments. Land transport is the most commonly used service and accounts for a share in costs ranging from 6.2 to 13.4 percent of the total inputs. Trade is by far the most important service sector input for the textile segments.

5.3 Cenvat Revenue from Textile Sector

Under Cenvat, total revenue raised was Rs. 2,166 crore in 2011-12 and Rs. 2,007 crore in 2012-13. Out of twenty groups of textile products listed in Table 5.5, four groups account for 85% of the Cenvat revenue in 2011-12. These are: Synthetic filament yarn and sewing thread including synthetic monofilament and waste, Artificial or Synthetic Staple Fibre & tow including waste, Articles of apparel and clothing accessories - knitted or crocheted, and Articles of apparel and clothing accessories not knitted or crocheted, Articles of apparel, considering knitted and non-knitted and crocheted and not-crocheted categories together, account for nearly 70% of the cenvat realized.

Table 5.5: Central Excise Collections

(Rs. Crore)

Textile Categories	2011-12			2012-13		
	PLA	Cenvat credit	Relative Share of PLA in Total (%)	PLA	Cenvat credit	Relative Share of PLA in Total (%)
Silk	0.00	2.86	0.00	0.28	6.09	0.01
Wool, fine or coarse animal hair	0.37	10.86	0.02	0.26	7.49	0.01
Cotton and cotton yarn	13.30	95.35	0.61	3.77	53.40	0.19
All others falling under Chapter 52 (Cotton fabrics)	5.83	50.06	0.27	3.21	34.38	0.16
Woven Fabrics of Jute (including bimplipatam jute or mesta fibres) or of other textile bast fibres	18.26	0.32	0.84	17.23	2.45	0.86
All others falling under Chapter 53	11.98	14.31	0.55	7.86	20.13	0.39
Synthetic filament yarn and sewing thread including synthetic monofilament and waste	151.48	2976.91	6.99	248.46	4158.43	12.38
Fabrics of man-made filament yarn	13.99	105.57	0.65	12.41	52.05	0.62
Artificial or Synthetic Staple Fibre & tow including waste	214.93	1008.55	9.92	295.93	1244.35	14.74
Spun Yarn containing Polyester or other Synthetic Yarn	1.17	146.21	0.05	1.29	166.77	0.06
Other Man-made blended Yarn	5.46	91.78	0.25	8.86	84.16	0.44
Fabrics of man-made staple fibers	3.24	86.47	0.15	6.48	80.45	0.32
Wadding, felt & non-woven, special yarns, twine, cordage, ropes & cables and articles thereof	18.90	132.35	0.87	29.67	166.72	1.48
Carpets & other textile floor coverings	11.46	27.83	0.53	14.84	34.96	0.74
Special woven fabrics, tufted textile fabrics, lace, embroidery	9.39	32.40	0.43	13.54	46.19	0.67
Impregnated, coated, covered or laminated textile fabrics, textile articles suitable for industrial use	87.22	390.57	4.03	112.29	489.17	5.59
Knitted or Crocheted fabrics	7.50	17.48	0.35	7.70	24.72	0.38
Articles of apparel and clothing accessories - knitted or crocheted	618.34	106.83	28.55	500.87	165.86	24.95
Articles of apparel and clothing accessories not knitted or crocheted	863.67	194.40	39.88	611.79	217.42	30.48
Other made up textile articles	109.36	98.59	5.05	110.36	105.73	5.50
Total	2165.86	5589.70	100.00	2007.10	7160.92	100.00

Source: Customs and Central Excise Department

The abbreviation PLA represents the Personal ledger Account which is an account of firms producing excisable goods, utilized for payment of duty of excise. It is a form of current account with the government in a prescribed bank wherein no minimum balance is required to be maintained. A manufacturer is required to pay excise duty in lump sum in the account by way of challan in form GAR-7 (earlier TR-6). On payment of such amount, credit can be taken in the PLA maintained by manufacturer.

Cenvat on input goods and input services is rebated whether the final product is exported or used in the country. That is why the amount of Cenvat credit is high. The share of PLA is relatively higher in categories like manmade filament yarn and manmade staple fibre filament yarn and articles of apparel where synthetic fibres or filaments are used involving petroleum sector inputs.

There are four main reasons why tax paid on inputs may be blocked. First, if the product in final purchase is exempt. Second, if the inputs are purchased by the unorganized sector from organized sector. It would have paid the tax earlier but credit cannot be claimed. Third, if output tax is less than the sum of input taxes and the claim is carried forward or refused. Fourth, the dealers are dissuaded from claiming ITC due to excessive paper work. We are able to capture the effects of the first two factors. These two are the main reasons for ITC blockage.

Input tax credited will be with respect to purchases by organized sector from organized sector, as this will be part of the value added chain. Purchases of inputs by organized sector from unorganized sector will also be credited in final sales. Purchases by unorganized sector from unorganized sector will totally escape tax payments. Purchases by unorganized sector from organized sector will have blocked cenvat credit on input taxes paid at earlier stages.

5.4 Revenues from State VAT and Related Tax Revenues from the Textile Sector

At the level of states, for taxation of textile products, three taxes are important in the present context: State VAT, central sales tax and entry tax.

Except for a few items, state governments have not been able to levy State VAT on textile products after the tax rental arrangement under additional excise duty (AED) in lieu of sales tax for textiles, tobacco, and sugar came to an end and the state governments were given the power to levy a sales tax/State VAT on the textile items also. Andhra Pradesh attempted this but had to withdraw it following considerable opposition from the textile producers and dealers. Most state governments feel that while it is difficult for them to levy the State VAT on textile items individually, they can all go for it at the same time based on a joint decision or under the guidance of the Empowered Committee of State Finance Ministers. In other words, there is potential revenue available to the State governments over and above what they are presently raising from the textile sector.

It is useful to review the process of withdrawal of the arrangement of additional excise duty on textiles in lieu of sales tax as it gives an idea of the revenue that should have been raised by the state governments through sales tax/VAT once the AED was withdrawn.

5.4.1 Additional Excise Duties on Textiles in lieu of Sales Tax

The Additional Duties of Excise (Goods of Special Importance) Act, 1957 was enacted by Parliament in December 1957. The objective of the legislation was to impose an additional duty of excise on certain goods of special importance in lieu of sales tax levied by the states on those goods. These goods were textiles, sugar, and tobacco. The scheme of levy of AED in lieu of sales tax on sugar, tobacco and textiles came into force after a decision was taken by the National Development Council (NDC) in December 1956. Because of the difficulties experienced in inter-state sales on a large scale of these articles, the Central Government with the concurrence of the State Governments had imposed an enhanced Central excise duty on the sale of those articles which was to be equivalent to and substitute for the sales tax levied upon them. The sum so collected by the imposition of the enhanced Central excise duty was to be distributed by the

Central Government to the State Governments who agreed to exempt those articles from sales tax. The distribution of the revenues raised under the additional excise duty has been done under the recommendations of the Finance Commission.

The net proceeds of AED were distributed among States in accordance with the principles laid down by successive Finance Commissions. The AED Act does not debar state governments from levying sales tax on these three items. However, if any state were to levy a tax on the sale or purchase of these commodities, it would not be entitled to a share of the proceeds of AED, unless the Union Government directs otherwise.

The Tenth Finance Commission had proposed an alternative scheme of devolution suggesting that the additional excise duties in lieu of sales tax be merged in the basic excise duty and the tax rental arrangement should be terminated (Para 13.14, Chapter 13, Report of the Tenth Finance Commission). The revenue on account of the AED was assessed to be 3 percent of the central tax revenues excluding surcharges. In the Tenth FC scheme, State governments were not supposed to levy a sales tax on these commodities.

In December 1996, the Government of India had brought out a Discussion Paper on the Alternative Scheme of Devolution spelling out the pros and cons of the scheme proposed by the Tenth FC. Eventually, this led to an amendment of the Constitution which fundamentally changed the arrangement of sharing of central taxes between the centre and states.³

In this context, the Eleventh FC observed that 'On the basis of our analysis and assessment of the Centre's and States' budgetary requirements we are of the view that the share of the States be fixed at 28 percent of the net proceeds of all taxes and duties referred to in the Union List, except the taxes and duties referred to in articles 268 and 269, and the surcharges and cesses'....The Commission noted that the Constitution (Eightieth) Amendment had come into force. The Commission recommended that 1.5 percent of all shareable Union taxes and duties be allocated to the States separately with reference to the sharing of revenues of additional excise duties in lieu of sales tax. They further recommended that if any State levies and collects sales tax on sugar, textile and tobacco, it will not be entitled to any share from this 1.5 percent.

³On the basis of a consensus reached in the Third Meeting of the Inter-State Council held on 17th July, 1997, the Government of India accepted the scheme with some modifications. A Constitution (Eighty-Fifth Amendment) Bill, 1998 was introduced in the 12th Lok Sabha. The Bill was referred to the Standing Committee of Parliament on Finance. The Standing Committee gave its report to the Parliament in the last week of February 1999. However, the Bill lapsed with the dissolution of the Lok Sabha. A modified version of the Bill was introduced in the Lok Sabha as 'The Constitution (Eighty-Ninth Amendment) Bill, 2000' on March 9, 2000. The Bill was passed by Parliament and received the assent of the President of India on June 9, 2000, as 'Constitution (Eightieth Amendment) Act, 2000.'

Subsequently, the Twelfth FC recommended that the share of the states in the net proceeds of shareable central taxes be raised from 29.5 percent to 30.5 percent. For this purpose, additional excise duties in lieu of sales tax on textiles, tobacco and sugar were treated as part of the general pool of central taxes. If, however, the tax rental arrangement is terminated and if states are allowed to levy sales tax (or VAT) on these commodities without any prescribed limit, the share of the states in the net proceeds of shareable central taxes will be 29.5 percent.

This indicates that over time, the revenues raised under the additional excise duty in lieu of sales tax was coming down as percentage of the sharable pool of central taxes: 3 percent at the time of Tenth FC, 1.5 percent at the time of Eleventh FC, and 1 percent at the time of Twelfth FC.

The last year in which revenue under the additional excise duty was shown separately in the Union Budget was in 2006-07⁴.

On the recommendation of the Twelfth FC, the Centre had stopped levying AED on these three items from 2006-07. After that, states started imposing VAT on tobacco, but sugar and textiles were not taxed. The reason was the Centre still used to give one percent devolution to states till 2010-11. This devolution was stopped from this year. Also, sugar and textiles were taken out of schedule of AED only from this fiscal. States continued to get 1 percent of the sharable pool of central taxes as additional devolution on account of AED in lieu of sales tax on textiles and sugar until the recommendations of the Thirteenth FC.

The Thirteenth FC observed: "All the goods under the Additional Duties of Excise (Goods of Special Importance) Act, 1957 have been exempted from the payment of duty under the Act from 1 March 2006. Following this exemption, the Centre had made suitable adjustments in the basic excise duty rates on cigarettes, beedis and sugar. We are not earmarking any portion of the recommended 32 percent states' share in shareable net central tax revenue as attributable to additional duties of excise in lieu of sales tax and are not recommending any reduction in the share of the states in the event of levy of VAT on textiles, tobacco and sugar by them."

⁴ It provided estimates of revenue under additional excise duty in lieu of sales tax for RE2005-06 at Rs. 2574 crore and BE2006-07 at 2742 Rs. crore. In the 2006-07 Budget, the excise duty structure was rationalized by merging the special excise duty (SED) and the additional excise duty (AED) with the Cenvat rate of 16%. Under the AED, the rate on textiles had been brought to nil two years back. In 2006-07, the AED rates on sugar and tobacco were also brought down to nil or in technical terms, zero-rated. Zero-rating of AED was considered a rationalisation measure, though the Centre had not yet given states the power to levy value added tax (VAT) on these three items. Technically, AED had to be withdrawn if states were to levy VAT and this required an amendment in the Additional Excise Duty (Goods of Special Importance) Act, 1957.

5.4.2 Potential Revenue from levy of VAT on textiles

Since the centre has already adjusted the basic excise duty rates to take account of the additional excise duty component for tobacco products and sugar, only textiles are left and the 1% of sharable pool of central taxes may be considered as pertaining to textiles.

After the recommendation of the Thirteenth FC, States had the option of levying VAT on textiles without fear of losing their share of 1 percent of the sharable pool of central taxes amounting to Rs. 6,200 crores in 2011-12 as given in Table 5.8. States have kept most textile items under the exempt category. Some of the States like Andhra Pradesh who tried to at least put a 4/5 percent VAT on textiles products had to withdraw.

Exemption implies that ITC on VAT paid on textile inputs is not available. Tax paid on inputs is also not shown as paid by textile dealers although it may be part of the price of the textile output.

5.5 Central and State Tax Rates

Tax revenue is the product of the tax rate and tax base. In this section, we look at the tax rates both of textile inputs and outputs for Cenvat and VAT rates in a selected set of States. Annex 4 explains in detail the procedure used for calculation of effective centre and state tax rates.

In the case of Cenvat, the effective rates are often different from statutory rates. The effective rates take into considerations any cesses, surcharges or rebate over and above the statutory rate. We have compiled the effective rates and added the applicable cesses/surcharges as given in Table 5.6.

Table 5.6: Effective Cenvat Rates: Textile Inputs and Outputs

(Percent)

Textile Inputs (Goods)	Rate	Textile Inputs (Services)	Rate	Textile Outputs	Rate
Jute	0.00	Railway transport services	3.09	Khadi, cotton textiles(handlooms)	0.00
Cotton	0.00	Land transport including via pipeline	2.58	Cotton textiles	5.15
Other crops	1.14	Air transport	10.30	Woollen textiles	10.30
Other liv.st. products	0.00	Communication	10.30	Silk textiles	10.30
Forestry and logging	4.46	Trade	0.00	Art silk, synthetic fibre textiles	10.30
Coal and lignite	18.78	Banking	10.30	Jute, hemp, mesta textiles	9.01
Natural gas	0.00	Insurance	10.30	Carpet weaving	9.24
Other non-metallic minerals	0.54	Business services	10.30	Readymade garments	8.32
Miscellaneous food products	5.15	Computer & related activities	10.30	Miscellaneous textile products	9.41
Leather and leather products	4.12	Legal services	10.30		
Rubber products	10.78	Renting of machinery & equipment	10.30		
Plastic products	10.30	O.com, social & personal services	10.30		
Petroleum products	33.74	Other services	10.30		
Inorganic heavy chemicals	10.30				
Organic heavy chemicals	10.30				
Paints, varnishes and lacquers	10.30				
Soaps, cosmetics & glycerine	10.30				
Synthetic fibers, resin	10.30				
Other chemicals	8.76				
Other non-metallic mineral prods.	9.44				
Miscellaneous metal products	9.01				
Industrial machinery(F & T)	7.73				
Machine tools	10.30				
Other electrical Machinery	10.30				
Electronic equipment (incl.TV)	10.30				
Miscellaneous manufacturing	8.58				
Construction	10.30				
Electricity	0.00				

Source: Central Excise Act and Manuals, 2011-12

For VAT rates, the selected states are Andhra Pradesh, Bihar, Maharashtra, Uttar Pradesh, and West Bengal. Together, these account for a little less than 50 percent of total all India consumption expenditure on textile items. The VAT rates for textile outputs and inputs are given in Table 5.7.

Table 5.7: VAT Rates: Textile Inputs (Goods and Outputs)

Type of Input	AP	BH	MH	UP	WB
Jute	4.5	0	5	5	0
Cotton	4.5	5	5	5	4
Other crops	0	5	5	5	4
Other liv.st. products	0	0	0	0	0
Forestry and logging	4.5	5	5	5	4
Coal and lignite	4.5	5	5	5	4
Natural gas	4.5	20	12.5	21.5	13.5
Other non-metallic minerals	4.5	5	5	5	4
Miscellaneous food products	4.5	5	5	5	4
Khadi, cotton textiles(handlooms)	0.0	0.0	0.0	0.0	0.0
Cotton textiles	1.3	1.2	1.3	1.3	1.1
Woollen textiles	1.9	2.1	2.1	2.1	1.7
Silk textiles	0.8	0.0	0.8	0.8	0.6
Art silk, synthetic fibre textiles	0.9	1.0	1.0	1.0	0.8
Jute, hemp, mesta textiles	3.3	3.6	3.6	3.6	2.9
Carpet weaving	1.6	1.8	1.8	1.8	1.4
Readymade garments	4.5	5.0	5.0	5.0	4.0
Miscellaneous textile products	4.5	5.0	5.0	5.0	4.0
Leather and leather products	14.5	13.5	12.5	13.5	13.5
Rubber products	4.5	5	5	5	4
Plastic products	4.5	5	5	5	4
Petroleum products	22.3	19.9	21	5	28.33
Inorganic heavy chemicals	4.5	5	5	5	4
Organic heavy chemicals	4.5	5	5	5	4
Paints, varnishes and lacquers	14.5	13.5	12.5	5	13.5
Soaps, cosmetics & glycerine	4.5	5	5	5	4
Synthetic fibers, resin	4.5	5	5	5	4
Other chemicals	4.5	5	5	5	4
Other non-metallic mineral prods.	4.5	4	4	5	4
Miscellaneous metal products	4.5	5	5	5	4
Industrial machinery(F & T)	4.5	5	5	5	4
Machine tools	4.5	5	5	5	4
Other electrical Machinery	4.5	5	5	5	4
Electronic equipment(incl.TV)	4.5	5	5	5	4
Miscellaneous manufacturing	4.5	5	5	5	4
Construction	4.5	1	5	6	2
Electricity	0	0	0	0	0

Source: State VAT Acts and Manuals

5.6 Estimation of Revenue Neutral Rates: Methodology

RNR estimation is done in two parts. First, given the present system of taxation, revenues are obtained from three main taxes: Cenvat (including cesses and surcharges), service tax and State VAT. For Cenvat, data are directly available although in broader categories. For service tax raised from the textile sector in the form of blocked input taxes, estimates have to be made. For State VAT (including CST, Entry Tax) also estimates have to be made as State VAT revenue specifically for the textile sector is not directly obtainable. This would provide an estimate of potential revenue from cenvat, service tax and State VAT from the textile sector. This potential revenue is then compared with the potential revenue under GST, which is obtained by applying a GST rate on the estimated tax base. The tax base consists of private and government final consumption expenditure according to different textile segments. The RNR of a textile segment answers the following question: what is the GST rate that if applied to the GST tax base would raise the same amount of revenue as under the present system of domestic indirect taxes. The comparison is made on both sides with respect to potential tax revenue given the tax bases.

The reference year is 2011-12.

For GST again, a taxable base has to be estimated and then GST rate has to be applied to obtain an estimate of potential revenue under GST.

Since the exercise has been done for different textile segments, it is possible to do simulations with combinations of exempted category, low rate category and standard rate category with provision for band rates.

Service tax is obtained by the central government at present since taxes paid on services are not rebated under State VAT although they may be rebated under central excise.

If the textile product is exported, service tax to the extent of unrebated ITC, may be recovered through some subsidies.

Service tax base is estimated by services purchased by textile manufacturers of organised sector from service providers of organized sector.

For estimation of State VAT, we have estimated the tax base by estimating the final domestic demand excluding exports but including imports and estimated potential revenue (and RNR) by application of the suitable GST rate. Annex 5 gives details of estimation of the total final demand while Annex 3 gives the details of the estimation of the share of organised and unorganised sector.

It may be noted that RNR can be calculated with reference to:

- (a) actual tax revenue that presently accrues under Cenvat and service tax and State VAT including CST and entry tax and
- (b) potential tax revenue under the present tax system which would also take into account tax evasion and potential revenue that the states could raise if they levied a sales tax on textiles. The states have not levied a sales tax since the arrangement under additional excise duty in lieu of sales tax was withdrawn.

5.6.1 Estimation of Textile Inputs and Outputs

In the present tax system, blocked input taxes are of considerable significance since a good number of output taxes are exempt. Therefore it is important to estimate both the inputs and outputs for the benchmark year 2011-12.

In the input-output matrix, the following relation holds:

$$AX+F=X$$

Where, A is the matrix of input-coefficients, F is the vector of final demand, and X is vector of gross value added.

This can be solved to write:

$$(I-A)^{-1}*F=X$$

And $(I-A)^{-1}F-F=I$, since $I=X-F$,

Where I is the vector of Intermediate use

Using these, we estimate all elements of commodity by commodity matrix, vector of intermediate uses (I), and vector of final demand (F) for 2011-12.

Thus,

$$X_{2011-12}=(I-A_{2007-08})^{-1}*F_{2011-12}$$

$$I_{2011-12}=X_{2011-12}-F_{2011-12}$$

$$X_{ij2011-12}=A_{ij2007-08}*X_{j2011-12}$$

Thus, using the final demand vector estimated from the national income accounts data for 2011-12 and the input-coefficients matrix of 2007-08, all the necessary input and output information is estimated for the relevant textile sectors.

The final demand itself consists of five components: private final consumption expenditure, government final consumption expenditure, gross fixed capital formation, change in stocks, and exports net of imports. The detailed methodology of sector-wise estimation of the components of the final demand is given in Annexure 5.

5.6.2 Estimation of Tax Base with Reference to the Present Tax System

The present taxes consist of three separate taxes: Cenvat, service tax, and State VAT. Cross ITC is available between Cenvat and service tax. Thus, Cenvat paid on inputs can be claimed by as credit in Cenvat paid on output. Service tax paid on service tax inputs to textile can also be claimed as credit against cenvat. State VAT on inputs cannot be claimed by ITC if there is no output tax.

Exports are zero rated in cenvat as well as State VAT.

Tax revenue consists of two components pertaining respectively to central taxes and state taxes.

The tax base consists of the sum of private and government final consumption expenditure on textile products. Since this includes the effect of indirect taxes net of

subsidies, this is taken out first by applying the segment wise net indirect tax ratios of the 2007-08 input output table.

Further adjustments are done separately for the base of central and state taxes.

Central Taxes

The central tax revenues consist of Cenvat paid by textile dealers, blocked input taxes of producers of textile inputs used for textile products, and blocked input taxes of non-textile inputs used for textile products excluding those on petroleum products.

Estimation procedure:

A1: Final domestic consumption expenditure is adjusted downwards to account for the fact that for cenvat the relevant value added is only up to manufacturing; value added margin for wholesale and retail are not available for taxation;

A2: This is further adjusted downwards to account for the lower number of dealers under Cenvat as the threshold limit is higher for goods at Rs. 1.5 crore although for services it is Rs. 10 lakh;

Input taxes paid on textile inputs can be divided into two parts: those credited in Cenvat chain and those blocked for a variety of reasons. Input taxes paid on petroleum inputs are not admissible.

Inputs purchased can be divided into four parts:

- (a) Purchases by organized sector from organized sector
- (b) Purchases by organized sector from unorganized sector
- (c) Purchases by unorganized sector from organized sector
- (d) Purchases by unorganized sector from unorganized sector

ITC should be available for (a) and (b). ITC would be blocked for (c). (d) would escape both taxation of the final product and ITC.

For ITC that is credit, (a) and (b) provide the relevant base. For ITC that is blocked (c) provides the relevant base. ITC would also be blocked if the final output is exempt.

State Taxes

State taxes relevant for the present discussion are State VAT, Central sales tax, and Entry tax.

The tax base of State VAT would be the sum of private and government final consumption expenditure where purchases are made from the organized sector. State VAT is applied when the good is produced and sold within the state or when the good is imported from another state and sold as local sale. There could be some part of sales that is brought from another state or imported but sold as local sale. In that case only CST will be charged. In some states local sales are subjected to entry tax.

5.6.3 Estimation of Revenue Neutral Rates: Textile Sector as a Whole

Table 5.8 provides estimates of revenue neutral rates for the textile sector as a whole. RNR for Cenvat and State VAT are estimated separately. In each case, RNR is considered in three parts: RNR only for taxes paid by textile dealers (output tax), RNR

when blocked input taxes are also included, and RNR when improved compliance is also taken into account.

In the case of State VAT, RNR is also estimated when states raise an amount expected to be raised if the AED system was continued.

Table 5.8: Revenue Neutral Rates: Textile Sector (Reference Year: 2011-12)

Head	Revenue (Rs crore)	RNR (%)
CGST		
RNR wrt to Cenvat paid by Textile Dealers	2,166	1.2
RNR wrt to Potential Cenvat (on Output)	5,771	3.1
RNR wrt Potential Cenvat including blocked input taxes	10,070	5.4
SGST		
RNR wrt to Potential Statevat (on Output)	3,526	1.9
RNR wrt to State VAT paid by Textile Dealers and blocked input taxes	6,238	3.6
RNR wrt Potential Statevat including blocked input taxes, CST, and ET	7,276	3.9
Benchmark: RNR wrt raising AED equivalent	6,197	3.3
Combined		
RNR wrt to Potential Cenvat and Statevat	17,346	9.3

Source: EY Estimates

Clearly, if we look only at the RNR with respect to output taxes paid by the textile dealers, it is very low. An appropriate comparison would be between potential tax revenue attributable to the textile sector that includes output tax and blocked input taxes applied on an estimated base under the present tax system and the potential revenue under GST estimated by applying a GST rate on an estimated base. In this comparison, the RNR comes out to be 9.3%. The RNR for the central taxes is 5.4 and that for state taxes is 4.0. This is still much lower than 12%, which might be the lowest rate (6% CGST and 6% SGST) in the dual tax regime. We conclude therefore that for the textile sector considered as a whole the movement to GST will lead to additional tax burden. If the GST rate is fixed at 12%, effectively the tax rate will increase by a margin of about 30 percent. However, there would be several positive and productivity enhancing effects of GST that may mitigate the adverse effect of the increased rate under GST. This is discussed in greater detail in Chapter 7.

5.6.4 Segment-wise Revenue Neutral Rates

Table 5.9 gives the estimates of revenue neutral rates for the main segments of the textile sector.

Table 5.9: Estimation of Revenue Neutral Rates

Sector	RNR (%)
Khadi, cotton textiles (handlooms)	4.0
Cotton textiles	7.1*
Woollen textiles	9.3
Silk textiles	9.6
Art silk, synthetic fibre textiles	10.2
Jute, hemp, mesta textiles	9.0
Carpet weaving	5.6
Readymade garments	10.5**
Miscellaneous textile products	12.0
All Segments	9.3

Source: EY Estimates

Notes:

* In the current regime of Central Excise, units are offered the option of not paying the output tax, if they do not claim any input tax credit. While detailed data are not available, industry observers indicate that more than 90% of the units take this optional route. This study assumes that the ITC involved is the same amount as the output tax liability and that is the reason why the Central Excise authorities have provided this option. If the actual ITC is lower than the output tax, the effective rate would be lower.

** In the case of Readymade Garments made purely out of cotton, including the Hosiery sector, the RNR would be closer to that of cotton textiles, which is 7.1%.

Table 5.9 indicates that RNRs are highest for the miscellaneous textile products and the readymade garments segments and relatively lower for the handloom, carpet weaving and cotton textile sectors.

In deciding a suitable form of GST for textiles, issues as to whether some segments can be exempted or whether selective concessions may be given often arise. It may be remembered that any exemptions or selective concessions would block input taxes, which will remain hidden as at present. What can be unambiguously argued is that if there is one single GST rate (CGST+SGST), it would suit the textile industry that this rate is kept as low as possible. If there is a dual rate, textiles should be placed at the lower rate.

Chapter 6: Textile Industry: Prospects and Policy Support

In this Chapter, we look at the prospects of structural changes being planned for the textile sector and the current regime of policy support. This will enable an examination of the role that the GST can play in facilitating the planned structural changes in the textile industry. Implementation of GST will also require a recasting of the current policy support regime.

6.1 Rebalancing Cotton and Manmade Fibres in Textile Product Mix

6.1.1 Cotton

As per National Fibre Policy (2010) document, India should look forward to a much higher growth in the man-made fibre segment as compared to the cotton based segment. Tables 6.1 and 6.2 indicate that over the five year period from 2015 to 2020, the manmade fibre segment should grow by more than 50% compared to its base in 2015, whereas the cotton based segment is slated to grow to the extent of about 26% in a five year period.

Table 6.1: Prospects of Production and Consumption of Cotton

(Figures in lakh bales)

Year	Production	Consumption	Surplus
2010-11	319	267	52
2014-15	384	323	61
2019-20	483	413	70
Growth (2019-20 over 2014-15) (%)	25.8	27.9	14.8

Source: National Fibre Policy, 2010-11, Ministry of Textiles, Government of India, 2010.

The gradual increase in cotton production over the years can largely be attributed to the phenomenal increase in the yield of cotton. The introduction of BT cotton seeds has played a catalytic role in enhancing cotton production in India. Cotton consumption has witnessed a sustained increase since 2003-04 due to the growing demand for Indian cotton textiles and subsequently, there has been considerable expansion and modernisation of the textile mills. Even though the Indian cotton consumption has increased at a rapid pace in the last few years, it has not kept pace with the growth in domestic cotton production, which has led to a surplus of production since 2003-2004. As a result, India has emerged as one of the top exporters of raw cotton in the world. Currently, India is the second-largest exporter of cotton after the US.

Table 6.2: Future Outlook for MMF/filament Yarn Demand

(Million kg)

Fibre	2015	2020	Growth (2020 over 2015)%
Polyester Staple Fibre	1,105.80	1,638.20	48.1
Viscose Staple Fibre	372.5	546.1	46.6
Acrylic Staple Fibre	133.3	180	35.0
Polypropylene Staple Fibre	3.9	6	53.8
Polyester Filament Yarn	2,129.20	3,366.30	58.1
Viscose Filament Yarn	66.7	96	43.9
NFY	47.1	72	52.9
Polypropylene Filament Yarn	62.7	96	53.1
Total MMF domestic demand	3,921.10	6,000.60	53.0
(+)Exports	470.5	720.1	53.0
(-)Imports	156.8	240	53.1
Total MMF requirement	4,234.80	6,480.60	53.0

Source: National Fibre Policy, 2010-11, Ministry of Textiles, Government of India, 2010.

6.1.2 Manmade Fibres

India is also the second largest producer of man-made fibres in the world (World Fibre Report 2008) with the presence of large plants having state-of-the art technology. MMF textiles constitute almost two-third of the domestic textile market. However, India's share in global exports of value-added textiles of manmade fibres is miniscule at around 2.25% in 2008 (India's MMF exports were US\$ 3.3 billion as against global exports of US\$ 146.7 billion). Hence, the domestic MMF: cotton fibre consumption ratio in India is 41:59 (FY09) while it is the reverse globally. The share of man-made fibres in total fibre consumption has risen from 25% in the early nineties to 41% at present. However, since quota abolition, the share of MMF in India's fibre consumption has almost stagnated at around 40% on account of rising cotton production and international demand for cotton by textile manufacturers to cater to export demand from global markets.

According to the National Fibre Policy 2010-11, India's capacity for man-made fibres stands at 3.4⁵ billion kg, which is around 6.6% of global MMF capacities. India's total production of manmade fibres stood at 2.5⁶ billion kg in FY09, of which exports constituted 10.1% at 0.25 billion kg. Imports constituted 0.12 billion kg. Indian man-made fibre industry is largely polyester dominated, which constitutes over 83% of total manmade fibre production.

While man-made fibre production is highly concentrated, with limited players engaged in manufacturing of MMF, the value added MMF textiles manufacture is primarily in the

⁵ 1.8 billion kg of man-made fibre in FY12 and 2.2 billion kg of man-made filament yarn in FY12 according to the Office of Textile Commissioner

⁶ 2.7 billion kgs of man-made fibres and filament in FY12 according to the Office of Textile Commissioner

decentralised sector, with the presence of a large number of small and medium enterprises. Production of MMF based fabrics has grown from 21 billion square meters in FY05 to 23.9⁷ billion square meters in FY09. While in the domestic market, MMF textiles and garments are dominant (65.70), cotton textiles are predominant in the export markets (over 80%).

According to the National Fibre Policy, 2010-11, considering future GDP growth of 8%, the domestic demand for man-made fibres/filament yarns is estimated at 3.9 billion kg in FY15 and about 6 billion kg in FY20. Adjusting to this the likely exports and imports of MMF, the overall MMF requirement is estimated at 4.2 billion kg for FY15 and 6.48 billion kg for FY20. This implies capacity additions of about 1.8 billion kg (FY15) and 4.6 billion kg (FY20), which would require an investment of over Rs 90⁸ billion by FY15 and Rs 230⁸ billion by FY20⁸. The PFY has a majority share in the MMF fibre demand and the country share in PSF is weak.

6.1.3 Jute and Silk

Jute is a rotational crop which is grown once a year between March/April and July/August. It employs more than 44 lakh people including jute farmers, workmen, labourers and self-employed artisans and weavers. It is a natural and environment friendly fibre. The current scenario of environment consciousness has opened a new potential for the sector, which can be exploited by entering into new markets and new products.

The production of raw jute has been stagnating at around 95 lakh bales during the last 10 years. With the proposed interventions in the farm & agriculture sector for increasing yield, it is expected that the production would increase to around 115 lakh bales by 2015 and to around 130 lakh bales by 2020 (CAGR = 3.2%). The production of jute goods too has registered a marginal growth of 0.1% in the last 10 years. With higher availability of raw jute and by modernization of jute industry, the jute goods production is projected to increase from present 16 lakh MT to 20 lakh MT by 2015 and 22 lakh MT by 2020 (CAGR = 3.2%). Product mix of jute goods is also expected to change, with less dependence on sacking (presently 70%) to 60% by 2015 and 50% by 2020.

Total Raw Silk production showed a growth of about 6.6% in 2009-10 after a period of stagnation during 2006-07 to 2009-10. Mulberry Raw silk, which constitutes almost 83% of India's total raw silk production, showed a growth of 4.6% during the same period and production of Vanya Silk jumped by 16%. In spite of several limiting factors, the silk industry in India has shown a growth of over 5% over last 10 years. Raw silk production is projected to grow at an average rate of 4.5% during the year 2010-2015 and 5.0% during 2015-20. The domestic consumption of raw silk is also expected to grow at 3.5% and 4.0% during the corresponding period.

In the next decade, consumption of raw wool is estimated to double, from 114.2 million kg in 2008-09 to 260.8 million kg by 2019-20 mainly on account of normal annual rise

⁷ 25.4 billion square meters in FY12 according to the Office of Textile Commissioner

⁸ National Fibre Policy, 2010-11

in domestic demand on account of increasing population further fuelled by rising incomes and over all higher standards of living. Besides, rise in consumption of raw wool is also expected due to increase in exports of woollen products manufactured from raw wool. During the period between 2009-10 and 2014-15, raw wool consumption is expected to grow at a CAGR of 7.8%; this growth rate is expected to be maintained during the period between 2015-16 and 2019-20 as well.

6.2 Modernization and Technology Up-gradation of the Textile Sector

Linked to the issue of increased production of man-made fibres, the textile industry needs to be modernized to become more export competitive. New machinery and new products through experimentation with blending and designing suitably combined with traditional skills will make this industry highly competitive in the world markets. As per the National Fibre Policy document, considering all sectors together, a large amount of new investment amounting to Rs. 188010 crore would have to be undertaken as detailed in Table 6.3.

Table 6.3: New Investment Requirement up to 2020: (For all sectors)

(Rs. Crore)	
Sector	Investment Requirement
Spinning	63,525
Weaving	38,485
Knitting	12,499
Processing	26,695
Garments	35,305
Technical Textiles	11,500
Grand total	1,88,010

Source: National Fibre Policy, 2010-11, Ministry of Textiles, Government of India, 2010

6.3 Policy Support to Textiles

6.3.1 Central Government Initiatives

The Indian Government has provided various schemes to support the textile sector. These schemes provide numerous benefits to Indian textile manufacturers. Highlights of these schemes with their key features are provided in Table 6.4.

Table 6.4: Key Features of Major Central Government Schemes

Scheme / Policy	Key Features
Scheme for Integrated Textile Parks (SITP)	Grant/Equity up to 40% of textile park development project cost to a ceiling of Rs 40 crore. Further 9% grant by State Govt. to strengthen infrastructure to a ceiling of Rs 9 crore.

Scheme / Policy	Key Features
Restructured Technological Upgradation Fund Scheme (RTUFS)	Reimbursement of 5% on the interest charged on technology up-gradation project except spinning where it is 4% Additional 10% capital subsidy for specified processing, garmenting, technical textile machinery and shuttle-less looms. Cover for foreign exchange rate fluctuation up to 5% Option for power loom and independent preparatory units to avail 20% Margin Money in lieu of 5% interest reimbursement. Option for SSI textile and jute sector to avail of 15% Margin Money subsidy in lieu of 5% interest reimbursement.
Integrated Development (ISDS) Skill Scheme	Aims to support skill development by training ~3 million people in textile sector. Provides fund support up to 75% of training cost per individual.
Swarnjayanti Gram Swarozgar Yojana (SGSY)	Provide assistance to people by providing them income generating skills through a mix of bank credit and government subsidy. Subsidy at a uniform rate of 30% of the project cost, subject up to Rs. 7500 per individual.
Market Development Assistance (MDA)	Financial support to textile manufacturer for conducting export promotion activities abroad. Assistance on air travel in economy class and/or charges of built up furnished stall, subject to a ceiling: <ul style="list-style-type: none"> • Focus Latin American Countries (LAC) – Rs. 1,80,000/- • Focus Africa, Focus CIS, Focus ASEAN – Rs. 1,50,000/- • General areas – Rs. 80,000/- For EPC led Trade Delegations/Buyer-Seller meets only economy air-fare up to a max. of Rs. 70,000 (Rs. 1,00,000 in case of Focus LAC) For each region, the exporter can claim benefit once a year <ul style="list-style-type: none"> • Maximum number of permissible participations to be 5 in a financial year.
Technology Mission on Technical Textiles (TMTT)	Upgrade existing Centre of Excellences and set up of four new COEs Support for business start-up Creating awareness through organizing workshops/ seminar Support for standardization Support for Market development targeted at bulk and institutional buyers Market development support for export sales Grant for conducting contract research in identified institutes
Market Access Initiative (MAI)	Financial support for conducting market studies/survey. 50% reimbursement of expenses incurred during trade promotion activities upto to a ceiling of Rs. 50 lakhs

Source: Ministry of Textiles

6.3.2 State Government Initiatives

Apart from the central government, many State Governments like those of Maharashtra, Gujarat, Tamil Nadu, Karnataka, Andhra Pradesh, Rajasthan, Madhya Pradesh and Punjab have launched various schemes to attract investments in their states. These are presented in Table 6.5.

Table 6.5: Key Features of State Government Textile Policies

Incentives\States	GJ	TN	MH	KT	AP	RJ	PB	MP
Infrastructure								
Land	✓	✓		✓	✓	✓	✓	✓
Electricity/Power	✓	✓	✓	✓	✓	✓	✓	
Fiscal								
Stamp duty exemptions		✓	✓	✓	✓	✓		
Interest subsidy	✓		✓	✓				✓
Entry tax exemptions				✓		✓		✓
Venture capital funding	✓		✓					
VAT/CST/SGST exemptions		✓		✓	✓	✓	✓	
Capital investment subsidies		✓	✓	✓	✓	✓		✓
Research and Development								
Patent and quality certification	✓	✓		✓	✓	✓		✓
Technology development and Upgradation	✓	✓	✓	✓		✓	✓	✓
Human Resource Development								
Skill development	✓			✓	✓	✓		✓
Employment		✓	✓	✓		✓		
Trade								
Export subsidies				✓		✓		
Import subsidies			✓					
Other								
Sick unit rehabilitation	✓		✓					
Energy and water conservation	✓	✓		✓	✓	✓		

Source: Respective state government websites, industry interface

India is one of the few textile manufacturing countries in the world where all levels of textile value chain i.e. from fibre/ filament to garment manufacturing are present.

6.3.3 Export Incentives

The central government has provided a number of schemes to support textile exports. These are discussed below.

6.3.3.1 Duty Drawback Scheme

The Duty Drawback scheme aims at promoting exports by seeking to rebate duty or tax chargeable on any imported/excisable goods and input services used in the manufacture of export goods. The duties and taxes neutralized under the scheme are (i) Customs and Union Excise Duties in respect of inputs and (ii) Service Tax in respect of input services. The Duty Drawback is of two types: (i) All Industry Rate and (ii) Brand Rate.

The All Industry Rate (AIR) is an average rate based on the average quantity/value of inputs, taxes (service tax) and duties (both Excise & Customs) borne by exporters. The

All Industry Rates are notified by the Government in the form of a Drawback Schedule every year and the present Schedule applicable from 21st September, 2013 covers more than 3,900 entries. The legal framework in this regard is provided under Sections 75 and 76 of the Customs Act, 1962 and the Customs and Central Excise Duties and Service Tax Drawback Rules, 1995 (henceforth referred as Drawback Rules).

The Brand Rate of Duty Drawback is allowed in cases where the export product does not have any AIR of Duty Drawback or the same neutralizes less than 4/5th of the duties paid on materials used in the manufacture of export goods. This work is handled by the jurisdictional Commissioners of Customs & Central Excise. Exporters who wish to avail of the Brand Rate of Duty Drawback need to apply for fixation of the rate for their export goods to the jurisdictional Central Excise Commissionerate. The Brand Rate of Duty Drawback is granted in terms of Rules 6 and 7 of the Drawback Rules, 1995.

All Industry Rate (AIR) of Duty Drawback

The AIR is fixed after extensive discussions with all stake holders viz. Export Promotion Councils, Trade Associations, and individual exporters to solicit relevant data, which includes the data on procurement prices of inputs, indigenous as well as imported, applicable duty rates, consumption ratios and FOB values of export products. Corroborating data is also collected from Central Excise and Customs field formations. This data is analysed and forms the basis for the All India Rate of Duty Drawback. The AIR of Duty Drawback is generally fixed as a percentage of FOB price of export product. Caps have been imposed in respect of many export products in order to obviate the possibility of misuse by unscrupulous exporters through over invoicing of the export value. They also safeguard government revenue in cases where high export prices are obtained which may not necessarily be correlated with the actual duties suffered on various inputs.

The scrutiny, sanction and payment of Duty Drawback claims in major Custom Houses are done through the Electronic Data Interchange (EDI) system. The EDI system facilitates credit/disbursal of Drawback directly to the exporter's bank accounts once the Export General Manifest (EGM) has been filed by respective airlines/shipping lines. The correct filing of Export General Manifest is essential for speedy processing and disbursal of Drawback claims.

Brand Rate of Duty Drawback

Where the export product has not been notified in AIR of Duty Drawback or where the exporter considers the AIR of Duty Drawback insufficient to fully neutralize the duties suffered by his export product, he may opt for the Brand Rate of Duty Drawback. Under this scheme, the exporters are compensated by paying the amount of Customs, Central Excise duties and Service Tax incidence actually incurred by the export product. For this purpose, the exporter has to produce documents/proof about the actual quantity of inputs/services utilized in the manufacture of export product along with evidence of payment of duties thereon.

Section 74 Drawback

In case of goods which were earlier imported on payment of duty and are later sought to be exported within a specified period, Customs duty paid at the time of import of the goods, with certain cuts, can be claimed as Duty Drawback at the time of export of such goods. Such Duty Drawback is granted in terms of Section 74 of the Customs Act, 1962

read with Re-export of Imported Goods (Drawback of Customs Duty) Rules, 1995. For this purpose, the identity of export goods is cross verified with the particulars furnished at the time of import of such goods.

Where the goods are not put into use after import, 98% of Duty Drawback is admissible under Section 74 of the Customs Act, 1962. In cases the goods have been put into use after import, Duty Drawback is granted on a sliding scale basis depending upon the extent of use of the goods. No Duty Drawback is available if the goods are exported 18 months after import. Application for Duty Drawback is required to be made within 3 months from the date of export of goods, which can be extended up to 12 months subject to conditions and payment of requisite fee as provided in the Drawback Rules, 1995.

Annex 6 lists the procedure for claiming duty drawback and the limitations on its admissibility.

6.3.3.2 Export Incentives with Duty Credit Scrips

Under these schemes specified products and specified sectors are incentivised by way of Duty Credit Scrips ranging from 2% to 5%. The Duty Credit may be used for import of inputs or goods including capital goods, provided the same is freely importable under ITC (HS). Additional customs duty/excise duty paid in cash or through debit under this scrip is adjusted as CENVAT Credit or Duty Drawback. These credits and drawbacks are given as per rules framed by the Department of Revenue. Recently the Supplement 2012-13 to the Policy announced on 5th June 2012 allowed the duty credit scrips to be utilized for payment of excise duty for domestic procurement. Earlier only scrips under (Served from India Scheme) SFIS were so permitted for procurement of goods from domestic market. Now all scrips are permitted to source from domestic market so as to encourage manufacturing, value addition and employment. These scrips and the items imported against them are freely transferable and can be sold in open market. Due to this feature of the scrip even if the exporter has no need of any imports for his own manufacture, he can convert the scrip into cash by selling it into open market and can add to his profits. Annex 7 lists the salient features of the duty credit scrips.

A brief summary of the various schemes in Chapter 3 of the Foreign Trade Policy relevant to the textile sector are as follows:

6.3.3.2.1 Focus Market Scheme

The objective of this scheme is to offset high freight cost and other externalities to select international markets with a view to enhancing India's export competitiveness in these countries.

According to the scheme, exporters of all products to notified countries (as in Table I and 2 of Appendix 37C of HBPv1) are entitled for Duty Credit Scrip equivalent to 3% of FOB value of exports for exports made from 27.8 2009 onwards. For exports to countries notified in Table 3 of Appendix 37 C (Special Focus Markets) the exporters are eligible for duty credit scrip @ 4% of FOB value, made w.e.f. 01.04.2011, 5-6-2012, 01-01-2013, or 01-05-2013, as the case may be.

The following categories of export products/sectors are ineligible for Duty Credit Scrip, under FMS scheme:

- ▶ Supplies made to SEZ units;

- ▶ Service Exports;
- ▶ Diamonds and other precious, semi-precious stones;
- ▶ Gold, silver, platinum and other precious metals in any form, including plain and studded Jewellery;
- ▶ Ores and Concentrates, of all types and in all forms;
- ▶ Cereals, of all types;
- ▶ Sugar, of all types and in all forms;
- ▶ Crude / Petroleum Oil & Crude / Petroleum based Products covered under ITC HS codes 2709 to 2715, of all types and in all forms; and
- ▶ Export of Milk and Milk Products covered under ITC HS Codes 0401 to 0406, 1 9011 001, 1 9011 010, 2105 & 3501.

Most recently, as per the Annual Supplement to the Foreign Trade Policy 2009-14 announced on 18.04.2013, Norway was added under Focus Market Scheme and Venezuela was added under Special Focus Market Scheme. The total number of countries under Focus Market Scheme and Special Focus Market Scheme thus became 125 and 50 respectively.

6.3.3.2.2 Focus Product Scheme

The objective of this scheme is to incentivise export of such products which have high export intensity/employment potential, so as to offset infrastructure inefficiencies and other associated costs involved in marketing of these products.

According to the scheme, exports of notified products (as in Appendix 37D of HBPv1) to all countries (including SEZ units) are entitled for Duty Credit scrip equivalent to 2% of FOB value of exports (in free foreign exchange) for export made from 27.8.2009 onwards, unless a specific date of export/period is specified by public notice/notification.

However, Special Focus Product(s)/sector(s), covered under Table 2 and Table 5 of Appendix 37D, are granted Duty Credit Scrip equivalent to 5% of FOB value of exports (in free foreign exchange) for exports made from 27.8.2009 onwards, unless a specific date of export/period is specified by public notice/notification.

Further, Focus Product(s)/sector(s) that are notified under Table 7 of Appendix 37D are granted additional Duty Credit Scrip equivalent to 2% of FOB value of exports (in free foreign exchange) over and above the existing rate for that product/sector from the admissible date of export/period specified in the public notice issued to notify the product/sector.

Market Linked Focus Products Scrip (MLFPS)

Export of Products/Sectors of high export intensity/employment potential (which are not covered under present Focus Product Scheme List) are incentivized at 2% of FOB value of exports (in free foreign exchange) under FPS when exported to the Linked Markets (countries), which are not covered in the present FMS list, as notified in Appendix 37D of HBPv1, for exports made from 27.8.2009 onwards, unless a specific date of export/period is specified by public notice/notification. The scheme MLFPS was extended from 01.04.2013 to 31.03.2014 for exports to USA and EU in respect of items falling in Chapter 61 and Chapter 62 of ITC (HS).

6.3.3.2.3 Status Holder Incentive Scheme

The applicant shall be categorized depending on his total FOB (FOR-for deemed exports) export performance during current plus previous three years (taken together) upon exceeding limit below. For Export House (EH) Status, export performance is necessary in at least two out of four years (i.e., current plus previous three years). Table 6.6 gives details of the status category specified by the DGFT.

Table 6.6: Status Holder Categorisation

Serial Number	Status Category	Export Performance FOB / FOR Value (Rupees Crores)
1	Export House (EH)	20
2	Star Export House (SEH)	100
3	Trading House (TH)	500
4	Star Trading House (STH)	2500
5	Premier Trading House (PTH)	7500

Source: Foreign Trade Policy 2009-14

Other conditions for grant of status category include:

- ▶ Exporters in Small Scale Industry (SSI)/Tiny Sector/Cottage Sector, Units registered with KVICs / KVIBs, Units located in North Eastern States, Sikkim and Jammu & Kashmir, Units exporting handloom/handicrafts / hand knotted or silk carpets, exporters exporting to countries in Latin America / CIS / sub-Saharan Africa as listed in Appendix-9, Units having ISO 9000 (series) / ISO 14000 (series) / WHOGMP /HACCP / SEI CMM level-II and above status granted by agencies listed in Appendix-6 of HBP v1, exports of services and exports of agro products shall be entitled for double weightage on exports made for grant of status. Double Weightage shall be admissible to Merchant as well as Manufacturer Exporters. However, a shipment can get double weightage only once in any one of above categories.
- ▶ Transfer of export performance from one to another is not permitted. Therefore disclaimer system shall not be allowed for counting of export turnover.
- ▶ Exports made on re-export basis shall not be counted for recognition.
- ▶ Exports made by subsidiary of a limited company shall be counted towards export performance of limited company for recognition only if limited company has a majority shareholding in subsidiary company.

The Government recognized that 'Status Holders' contribute about 60% of India's goods exports. To incentivise and encourage the status holders, as well as to promote investment in upgradation of technology of some specified sectors including Handicrafts, Textiles and Jute, Status Holders were entitled to incentive scrip @1% of FOB value of exports made during 2009-10, 2010-11 and during 2011-12, of these specified sectors, in the form of duty credit. The scheme was further extended to 2012-13 but has been withdrawn for the year 2013-14. The credit could be used to set off duties paid on imports of capital goods. The status holder incentive scrip scheme was also expanded to cover more export product groups including marine products, sports goods, toys, specified chemicals and allied products and additional engineering products. The following Sectors are eligible for the Status Holders Incentive Scrip:

- ▶ Leather Sector (excluding finished leather);
- ▶ Textiles and Jute Sector;

- ▶ Handicrafts;
- ▶ Engineering Sector (excluding Iron & Steel, Nonferrous Metals in primary or intermediate forms, Automobiles & two wheelers, nuclear reactors & parts and Ships, Boats and Floating Structures);
- ▶ Plastics
- ▶ Basic Chemicals (excluding Pharma Products)

This credit was over and above any duty credit scrip claimed/availed under the respective chapter of the Foreign Trade Policy. Status Holders availing Technology Upgradation Fund Scheme (TUFS) benefits (under Ministry of Textiles) during a particular year were not eligible for Status Holders Incentive Scrip for exports of that year.

For FMS, FPS (including MLFPS) and Status Holders Incentive Scrip, the following exports categories/sectors are/were ineligible for Duty Credit Scrip entitlement:

- ▶ EOUs / EHTPs / BTPs who are availing direct tax benefits / exemption;
- ▶ Export of imported goods is not restricted for import or export in ITC (HS);
- ▶ Exports through transshipment, meaning thereby that exports originating in third country but transshipped through India;
- ▶ Deemed Exports;
- ▶ Exports made by SEZ units or SEZ products exported through DTA units; and
- ▶ Items, which are restricted or prohibited for export under Schedule-2 of Export Policy in ITC (HS).

Export Promotion Capital Goods Scheme

The EPCG scheme allows import of capital goods for pre-production, production and post-production at zero customs duty, subject to an export obligation equivalent to 6 times of duty saved on capital goods imported under EPCG scheme, to be fulfilled in 6 years reckoned from Authorization issue-date. The export obligation is required to be fulfilled by the export of goods capable of being manufactured or produced by the use of the capital goods imported under the scheme.

The scheme is available for exporters of certain sectors including engineering & electronic products, basic chemicals & pharmaceuticals, apparels & textiles, plastics, handicrafts, chemicals & allied products, leather & leather products, paper & paperboard and articles thereof, ceramic products, refractories, glass & glassware, rubber & articles thereof, plywood and allied products, marine products, sports goods and toys.

However, the scheme is not available for exporters who avail benefits under TUFS or Status Holder incentive Scheme.

Under the main scheme a concessional 3% Duty EPCG Scheme is also available. Under this scheme, import of capital goods for pre-production, production and post-production are allowed subject to payment of 3% Basic Customs Duty (BCD). Export obligation (EO) shall be 8 times of duty saved amount (i.e. difference between duty payable and 3% BCD). The Export Obligation Period (EOP) shall be 8 years.

Export Credit Guarantee Corporation of India

The Export Credit Guarantee Corporation of India Ltd. (ECGC) is a Government of India Enterprise which provides export credit insurance facilities to exporters including

textile exporters, with the objective of improving the competitive capacity of Indian exporters by giving them credit insurance covers at competitive rates. It functions under the administrative control of Ministry of Commerce & Industry, and is managed by a Board of Directors comprising representatives of the Government, Reserve Bank of India, banking, insurance and exporting community.

The ECGC is now the seventh largest credit insurer of the world in terms of coverage of national exports according to information published on its website. The present paid up capital as well as authorised capital of the Company is Rs. 1,000 Crores. The organisation is a member of the Berne Union as well.

The role of the organisation is defined by it as follows:

- ▶ Providing export credit insurance covers to exporters against loss in export of goods & services under Short Term & Medium & Long Term Policy Schemes
- ▶ Providing export credit insurance covers to banks & financial institutions to enable exporters obtain better facilities from them
- ▶ Providing cover for buyers credit/line of credit(LCs) to Banks/ FIs
- ▶ Providing overseas investment insurance to Indian investors in overseas ventures (equity/loans)

Thus broadly ECGC provides four types of services or schemes. (a) standard protection to exporters against payment risks involved in exports on short-term credit (b) specific protection to Indian firms against payment risks involved in exports on deferred terms of payment, services rendered to foreign clients, and turnkey projects taken abroad (c) financial guarantee to Indian banks to protect them against risks in extending financial support to exporters both at pre and post-shipment, and (d) special covers such as Transfer guarantee, insurance for buyer's credit, overseas investment insurance, and exchange risk fluctuation. Schemes (a) and (b) are for the exporters whereas (c) and (d) are for the banks. Schemes (a) and (c) are for a short term whereas those under (b) and (d) are for long-term.

The kinds of political risks covered are:

- ▶ War, Civil war, Internal disturbances
- ▶ Exchange transfer blockages/delay
- ▶ New import restrictions, cancellation of import license, etc.
- ▶ Diversion of voyage due to war

The firm covers political risks by dividing countries into two groups. Group I are countries under open cover category where political risks are automatically covered on submission of declaration and payment of premium. Group II consists of restricted cover countries where prior approval for cover for political risks is mandatory for cover even on political risks to be available.

Commercial risk cover is available on buyer for non-Line of Credit (LC) transactions and for Banks who have opened LCs. The kind of commercial risks covered are:

- ▶ Insolvency of buyer/bank
- ▶ Non acceptance of exported shipment
- ▶ Default of buyer/bank
- ▶ Insolvency of the LC opening bank
- ▶ Default of the LC opening bank

Risks that the firm does not cover are the following:

- ▶ Non fulfilment of contractual obligations by exporter including quality dispute
- ▶ Default or insolvency or any omission/commission of any agent of exporter/ buyer
- ▶ Failure of buyer to obtain necessary approvals for imports
- ▶ Causes inherent in nature of goods
- ▶ Exchange fluctuation risks
- ▶ Physical loss/damage to goods

The various schemes of the firm have been framed according to the requirement of specific category of exporters as well as according to the kind of transactions. Short-term schemes for exporters are ideally made for credit not exceeding 180 days. Medium and Long-term credit rules are framed for credit exceeding 180 days. Short-term policies are offered either on the basis of the total turnover of the exporter or his level of exposure. The schemes available to exporters are given in Table 1.1 below. Salient features of certain key policies are given in the Appendix.

Technology Upgradation Fund Scheme (TUFS)

TUFS was commissioned by the Government of India in 1999 to facilitate modernisation and upgradation of the textile industry. Under this scheme, GoI provides credit to manufacturers in the organised and unorganised textile sector at reduced rates. It provides a reimbursement of 5% on the interest charged on technology up-gradation projects except spinning where it is 4%. Additional 10% capital subsidy is also available for specified processing, garmenting, technical textile machinery and shuttle-less looms. These subsidies are available on loans availed by units from eligible Primary Lending Institutions (PLIs) for undertaking technology upgradation/modernisation including installation of machinery for manufacture of technical textiles, garmenting machinery and processing machinery under TUFS. A cover for foreign exchange fluctuation upto 5% is also made available on purchase of imported machinery. Moreover, in lieu of the 5% interest reimbursement, power loom and independent preparatory units are provided an option to avail 20% Margin Money while SSI textile and jute sector can similarly avail 15% Margin Money subsidy. However, at present, TUFS is not applicable to manufacture of synthetic fibres as the sector falls under the ambit of Department of Chemicals and Petrochemicals.

The scheme has been regularly rolled over and is currently operational. The Government has recommended continuation of TUFS with an allocation of Rs. 158.9 bn for the entire 12th Five Year Plan.

6.4 Perspective on WTO Restrictions

The WTO provisions on subsidies and countervailing measures in respect of trade in goods are contained in Articles VI and XVI of GATT 1994, the Agreement on Subsidies and Countervailing Measures (ASCM) and the Agreement on Agriculture.

The legal definition of a subsidy is narrower in the ASCM. Only those subsidies which are specific to an enterprise or industry or group of enterprises or industries are covered. Thus a subsidy is deemed as specific where the relevant granting authority explicitly limit the granting of a subsidy to certain enterprises, are deemed as specific. Such subsidies distort the allocation of resources in an economy.

The ASCM lists three kinds of subsidies according to the traffic lights approach – red, green and amber. The three kinds of subsidies are:

- ▶ Prohibited subsidies (red)
- ▶ Permissible but also immune from action by trading partners (green)
- ▶ Permissible but actionable by trading partners (amber)

According to Article 27.10, in countervailing duty investigations against subsidised exports from developing countries, the proceedings have to be terminated if the overall level of subsidies is less than 2 percent (as against one percent for others), or if the volume of subsidised imports is less than 4 percent of the total imports. The rule of exemption from countervailing duty proceedings, if the volumes of subsidised imports are less than 4 percent, does not apply if the cumulative share of imports from individual countries accounting for less than 4 percent is more than 9 percent.

The ASCM can potentially have a large impact on the subsidies provided by the Central government to various sectors including the textile sector. Prohibited subsidies for India are those that are contingent upon local content substitution. It is currently exempt from prohibition of export subsidies according to Article 27.2(a). Any subsidies that are specific are also actionable although India cannot be booked under the clause of serious prejudice. According to Article 27.9, a Member may only bring a claim that benefits under GATT have been nullified or impaired by a developing country Member's subsidies or that subsidized imports into the complaining Member have caused injury to a domestic industry. The materiality of injury to a domestic industry of an importer is dependent upon the volume of subsidised imports, its impact on domestic market prices of 'like' product and the consequent impact of these imports on domestic producers of such products. In such a case a member may be booked under Article 7. Also, if a specific subsidy granted crosses the de minimis level of 2% of the total value of imports, and the volume of total imports represents more than 4% of total imports of the specific product, then the importing member can issue countervailing measures against the imported product provided there is a material injury to the domestic industry of the importer and a causal link between the subsidy and the injury can be established. However, action can either be taken under Article 7 (Dispute Settlement Board) or by means of imposing a countervailing measure, not both.

With respect to a specific product (as in a 'section' under HS Code), if exports from India constitute more than 3.25% of the total world trade then India is liable to phase out subsidies granted to the respective sector over a period of eight years.

Hence, to determine whether existing subsidies in the India are in conformance with the ASCM, the following points need to be checked:

- 1) Whether the subsidy comes under the definition of specific subsidy as per the agreement
- 2) Whether the subsidy is prohibited or actionable or countervailable
- 3) Whether the subsidy is for a product coming under a section-heading that India has achieved export competitiveness in.

India has several export subsidies which are relevant to the textile sector as summarized earlier in this chapter. They are listed along with observations on their conformance with the WTO provisions under the ASCM below:

1) Duty Drawback:

Provision (h) of Annex I states that that "prior-stage cumulative indirect taxes may be exempted, remitted or deferred on exported products even when not exempted, remitted or deferred on like products when sold for domestic consumption, if the prior-

stage cumulative indirect taxes are levied on inputs that are consumed in the production of the exported product (making normal allowance for waste)."

Annex II of the ASCM defines 'inputs consumed in the production process' as 'inputs physically incorporated, energy, fuels and oils used in the production process and catalysts consumed in the course of their use'. Thus, capital goods have been left out even though they can be said to have been used to the extent of their depreciation.

2) Export Promotion Capital Goods Scheme:

EPCG scheme is treated as a countervailable subsidy which is valid as the government makes a financial contribution by partially exempting the duty. Thus the contribution can be termed as a subsidy under Article 1.1(ii) of the ASCM. Since the benefit is contingent upon export performance it is an export subsidy and such a subsidy is deemed to be specific under Article 3.1(a) of the ASCM.

The US, European Community and Canada have all successfully levied countervailing duties against the subsidy in the past. In the final CVD determinations in Certain Cut-to-Length Carbon Steel Plate from India (1999) and Certain Hot-Rolled Carbon Steel Flat Products from India (2001), the US Department of Commerce countervailed against the scheme. The CVD on Hot-Rolled Carbon Steel Flat Products was extended for a further five years after it expired in 2007.

3) Export Credit Guarantee Corporation of India (ECGC)

Broadly, ECGC provides four types of services or schemes. (a) standard protection to exporters against payment risks involved in exports on short-term credit (b) specific protection to Indian firms against payment risks involved in exports on deferred terms of payment, services rendered to foreign clients, and turnkey projects taken abroad (c) financial guarantee to Indian banks to protect them against risks in extending financial support to exporters both at pre and post-shipment, and (d) special covers such as Transfer guarantee, insurance for buyer's credit, overseas investment insurance, and exchange risk fluctuation.

According to Annex I (j) of the Agreement, a subsidy occurs where premium rate at which credit guarantee is given is inadequate to cover long-term operating costs and losses. A study by ICRIER in 2001 shows viability of ECGC operations on the basis of its long-term operations. Total premium collected by ECGC from 1957 to March 2000 has been Rs. 2118.38 crores. Added to this, are the recoveries of Rs. 348.8 crores made during the same period. The premium plus recoveries are higher than the claims of Rs. 1928.24 crores paid by ECGC over the same period. ECGC has thus been maintaining its financial viability. Its profit during 1997-98, 1998-99 and 1999-2000 has been Rs. 4.24 crore, Rs. 23.14 crores, and Rs. 33.3 crores respectively. ECGC has been making positive profits overall on its operations. However, there is an element of cross-subsidy across the 4 schemes mentioned above. In particular, schemes (a) and (c) mentioned above are profit making on yearly basis for the last 6 years that have been considered. It is appropriate to examine these two schemes on a yearly basis since these are essentially short term in nature. However, schemes (b) and (d) being long term in nature have been loss making on yearly basis as well as on a long term basis. The SCM Agreement is not very clear on the issue of cross-subsidy across the schemes.

4) Status Holder Incentive Scheme

In the context of conformance to WTO rules two factors come into play:

1. The scheme is a specific subsidy since it is available to certain sectors alone, besides the fact that it is available for capital goods and is based on export performance. Moreover, it is in addition to the duty drawback rate. Hence, it is actionable under Article 5 as well as countervailable.
2. However, if the value of the subsidy is below the *de minimis* level of 2% of the value of exports and if the overall value of the subsidy on a specific product also falls below 2%, countervailing measures would not be allowed against the product. Duty drawback can not be used to calculate the effective level of subsidy since it is not a specific subsidy.

5) Focus Market Scheme

The scheme is in addition to the duty drawback scheme which seeks to reimburse excise duty, customs duty and service tax paid on inputs (excluding capital inputs). Annex I (g) which contains an illustrative list of export subsidies also include "The exemption or remission, in respect of the production and distribution of exported products, of indirect taxes in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption". Hence, it is a specific subsidy that is actionable as well as countervailable.

6) Focus Product Scheme

Since the scheme is a specific subsidy granted to certain notified sectors/industries, and in addition to the duty drawback scheme which provides cover against duty paid on excise, customs and service tax, it is actionable under Article 5. However, since it just reaches the *de minimis* limit of export subsidies, if the overall level of subsidies does not cross the limit of 2%, products falling under the scheme cannot be countervailed against.

7) Technology Upgradation Fund Scheme (TUFS)

TUFS is clearly a scheme that qualifies as a specific subsidy since it caters to the textile sector alone. It is specific and is hence actionable under Articles 5(a) and Article 5(b). That is, if it causes injury to the domestic industry of an importing member the member has the right to go to the dispute settlement board or impose countervailing duties.

8) Scheme for Integrated Textile Parks (SITP)

Whether the scheme can be called a subsidy would depend upon the rate at which the government provides funds to the textile units vis-à-vis the corresponding commercial benchmark rates. If the rates are lower than market rates, then the scheme would qualify as a subsidy and moreover as a specific subsidy since it caters to a specific industry only. Hence, it would be actionable as well as countervailable if it causes material injury to the domestic industry of the importing member.

9) Export Oriented Units (EOUs), Export Processing Zones (EPZs)

Annex II allows for (b), (c), and (d) but not for (a). The suspension of duties on import of capital goods within EOUs/EPZs/SEZs/EHTPs/STPs without the payment of customs is countervailable within the Agreement even if the duty is only deferred during the period of bonding as has been argued by GOI. Even if the duty is payable at a rate proportionate to the depreciated value of capital goods when the capital goods are debonded or sold, some duty is still foregone to the extent proportional to the accrued depreciated value. The duty foregone represents financial contribution by the GOI, conferring benefit to the units within the defined regions. Moreover, if and when to de-

bond the capital good, is a commercial decision taken by a company. Therefore, import of capital goods duty free within these regions constitutes a subsidy and since it is contingent on export performance within the meaning of Article 3.1 (a) of the ASCM Agreement, and is therefore specific and hence is countervailable.

Hence, apart from Duty Drawback and Export Oriented Units most of the other schemes do not conform to the Agreement on Subsidies and Countervailing Measures and can be potentially countervailed against, if not already done.

Chapter 7: Textile Industry: Implications of GST

7.1 Introduction

In this Chapter, we consider the implications of GST for the textile industry in India. This analysis is taken up in two parts: (a) positive effects of GST on manufacturing in general, which will also benefit the textile industry; and (b) implications of GST specific to the textile industry in India. In the first part, we consider the effects of GST on the growth, productivity, and employment through better resource allocation and capital augmentation. In the second part, we consider facilitation of rebalancing of textile output between cotton and man-made fibres through a fibre-neutral GST rate structure and its implication for textile prices and exports. We also consider the implications of the enhanced tax rate on textile under GST and how to neutralize its effect through a recasting of the present policy support schemes, some of which will become redundant under GST. GST will also have a significant revenue implication both for the central and state governments as it will reduce tax evasion and subject the textile tax bases to GST rates which may be lower or standard rates.

If applied uniformly, GST is likely to address all the major concerns of industry. It will eliminate any blockage of input taxes caused due to break of input tax credit chain. It will provide level playing field to all segments of textile industry. There will be a shift in tax burden from production to consumption as GST is a consumption tax. There will be significant simplification in compliance due to GSTN.

An important determinant of the tax incidence under GST will be the GST rate applicable to the textile segments. We note, as indicated below, that some of the prevailing VAT rates on textiles in some international jurisdictions are in the range of 5% to 20%.

- ▶ South Asia: Pakistan (5%), Bangladesh (15%), Sri Lanka (12%)
- ▶ China: 13%, 3% for SMEs without input tax credit
- ▶ Developed nations: Australia (10%), New Zealand (15%), Japan (5%, 8% from 1 April 2014 and 10% from 1 Oct 2015), UK (20%), Germany (19%), France (19.6%)

The main implications of GST compared to the present domestic indirect tax regime in the context of Textiles are as follows:

1. CGST and SGST rates are likely to be higher than the corresponding textile sector RNRs; as a result the central and state government will get higher revenues than at present; and textile prices would go up (Rate-Revenue Augmentation Effect);
2. GST is likely to have a fibre-neutral rate structure unless differentiation is introduced by explicit choice (Fibre Neutrality Effect);
3. Textile outputs will be taxed if domestically consumed and input taxes paid will be rebated making the tax-regime transparent (Transparency Effect);
4. Exports will be zero-rated and all input taxes paid will be rebated by the tax authorities making duty drawback kind of schemes redundant (Export Zero-rating Effect);
5. Fiscal barriers to inter-state movement of textile inputs and outputs like the CST and the entry tax will be eliminated (Common Market Effect);

6. Taxes on capital and machinery will be fully rebated (Investment Promoting Effect); and
7. For the industry, compliance costs will be lower (Compliance Promoting Effect).

All effects other than the first will have a positive effect on the industry. The first effect, namely the augmented rate and revenue effect through a hike of tax rates under GST, will have an adverse effect as it would lead to a price increase. This arises partly because State governments have not been able to levy a sales tax on textile after the withdrawal of the arrangement under additional excise duty in lieu of sales tax. This would therefore amount to giving to the textile industry the same treatment as other industries. However, given that part of the textile products constitute goods of mass consumption, this adverse effect will have to be neutralized partly through the higher productivity linked to GST (through better resource allocation and infusion of new technology) and partly through adequate policy recasting using the additional revenues that the central and state government may earn.

7.2 General Effects of GST

7.2.1 Selected International Experience

In a recent empirical study, Keen and Lockwood (2007) examine this question in an inter-country context. They take an unbalanced panel dataset consisting of 143 countries over 26 years (1975 – 2000). While it is difficult to assess the efficiency gains from the VAT directly, an indirect method is applied. It is shown that, in principle, under weak conditions, the availability of a more efficient tax instrument would lead to an increase in the tax- GDP ratio by an optimizing (though not necessarily *benevolent*) government, all else equal.⁹The next step is to test for any significant impact of the presence of the VAT on this ratio and if it is positive.

⁹Keen and Lockwood (2007) consider a stylized economy with a single representative consumer whose preferences are described by $U(C, G)$ expressed in terms of private consumption C and public expenditure G . It is assumed that U is strictly increasing in C and G ; quasi-concave and C is normal in demand. G is financed through taxation that yields R as tax revenue. As a result, the welfare of the consumer becomes $U(Y-R, R)$; Y is gross income, being a function $Y(R, V)$ where V represents the nature of tax instruments available. Pre-tax income Y decreases with R , showing the inefficiency loss due to taxation. Thus, $-Y_R > 0$ (the marginal deadweight loss due to taxation is positive). A tax innovation (the introduction of VAT, in this analysis) would improve efficiency of the tax system if it reduces the marginal deadweight loss due to taxation i.e. $Y_{RV} > 0$.

In a specific case of a benevolent state, the government will opt for that value of R that maximizes the consumer's welfare given as $U[Y(R, V) - R, R]$. From this, the modified Samuelson rule is obtained: the marginal willingness to pay for the public good is equal to unity plus the marginal deadweight loss due to taxation i.e. $(U_G / U_C) = 1 - Y_R > 1$. The tax-GDP ratio is $r = R / Y$. The impact of the VAT on revenue can be understood by following the standard tax effort equation: $r = \beta_0 + \beta_1 V + \beta_2 Y + \beta_3 VY$. By observing the coefficient of V , the money-machine argument can be tested. An important result is that the tax ratio r will be positively associated

It is argued that, if rolled out properly, the VAT is a very efficient tax. The efficiency gains are identified as coming from replacing taxes like the turnover tax and sales tax (which can potentially induce production inefficiencies and tax evasion). Adoption of the VAT has also come as part of trade reform packages. In the context of developing countries, it is viewed as a step towards tax administration reforms, better compliance and self-assessment.

However, if the VAT chain is broken, then it is a potential source of inefficiencies, largely related to production. It is also vulnerable to missing trader frauds in collusive criminal actions. On the implementation front, if the refund mechanism is imperfect, then the VAT could create counterproductive effects on exports and output in general. Welfare reductions are also highlighted in the VAT regime with respect to inducing larger scale informal production by increasing the VAT tax base.

The political economy effect of a federal structure of tax administration reducing the possibility of adopting the VAT has also been studied. This is true of cases where substantial sales tax powers are vested with lower tiers of the state and VAT implementation would cause difficulties in the absence of border controls. The results show strong positive influence of trade openness on the tax-GDP ratio and a negative effect of share of agriculture. Agriculture, as a sector, is hard to tax in general and the effect is more marked for a tax like VAT. Per capita income shows a negative effect on the tax-GDP ratio, indicating that when the efficiency costs of taxation are taken into account, the preference for larger public spending would decline with income. A larger older population is also seen to impose significant fiscal costs and calls for a higher tax-GDP ratio. The VAT-specific effects are that the revenue impact is positive from the per capita income and openness aspects. With a VAT, higher income countries and more open economies experience a rise in the tax-GDP ratio.¹⁰ At higher income levels, countries adjust to a new VAT regime more easily and collect more tax revenue. Although more open economies were seen to be less likely to adopt the VAT, once it is taken up (which would involve significant restructuring of tax administration), the revenue effect is positive due to the ease of collection from imports.

with the presence of VAT if the adoption of the VAT reduces the marginal deadweight loss due to taxation. These broad concepts still hold even if the condition of a benevolent state is relaxed.

¹⁰Keen and Lockwood (2007) use the following equation to identify the causes of and assess the impact of the VAT on the tax-GDP ratio:

$$r_{it} = \alpha V_{it} + \beta' X_{it} + \beta'_V V_{it} X_{it} + \mu_i + \gamma_t + u_{it}$$

where i and t indicate country and time respectively,

V_{it} is a dummy variable taking the value 1 in the presence of VAT in a country i in the year t , 0 otherwise

X_{it} represents the set of variables that influence the tax-GDP ratio r

μ_i is the country specific effect

γ_t is the time effect

u_{it} is the error term, assumed to be uncorrelated both temporally and spatially (over time and across countries)

Keen and Lockwood (2007) also show that most countries that adopt the VAT tend to largely gain from the exercise (with sub-Saharan African region presenting a less clear picture). It is estimated that the long run effect on the tax-GDP ratio is around 4.5% increase with a VAT in place. VAT is also accompanied by an improvement in the effectiveness in the tax system (in the absence of which the tax would not be opted for in the first place). Martinez-Vazques and Bird (2010) estimate that the increase in the tax-GDP ratio for developing countries can be even higher when they adopt VAT.

7.2.2 India-specific General Effects

In the context of India, a study by NCAER, attempted to quantify the positive effects of GST under certain assumptions (NCAER, 2009) on the general economy. Its main findings may be summarized as follows:

1. Implementation of a comprehensive GST is expected, ceteris paribus, to provide gains to India’s GDP somewhere in the range of 0.9 to 1.7 percent.
2. The real returns to factors of production will go up: returns to land will go up between 0.42 to 0.82 percent; wage rate gains will be in the range of 0.68 to 1.33 percent; returns to capital would increase in the range of 0.37 to 0.82 percent.
3. The overall price level would go down;
4. The efficiency of energy resource use will improve;
5. The manufacturing sectors including textiles and readymade garments would benefit from economies of scale;
6. Some sectors will experience a high proportional increase in exports. This list includes textiles and readymade garments.

In this analysis changes in prices following the imposition of GST are seen as an outcome of two opposite factors: one, there would be increased payments to primary factors of production with a cost-push positive effect on prices and second, there would be economies of scale in the manufacturing sectors. This would have, through increasing returns to scale in sectors that are under imperfect competition, a cost-reducing effect.

Figure 7.1: Productivity Improving Channels of GST

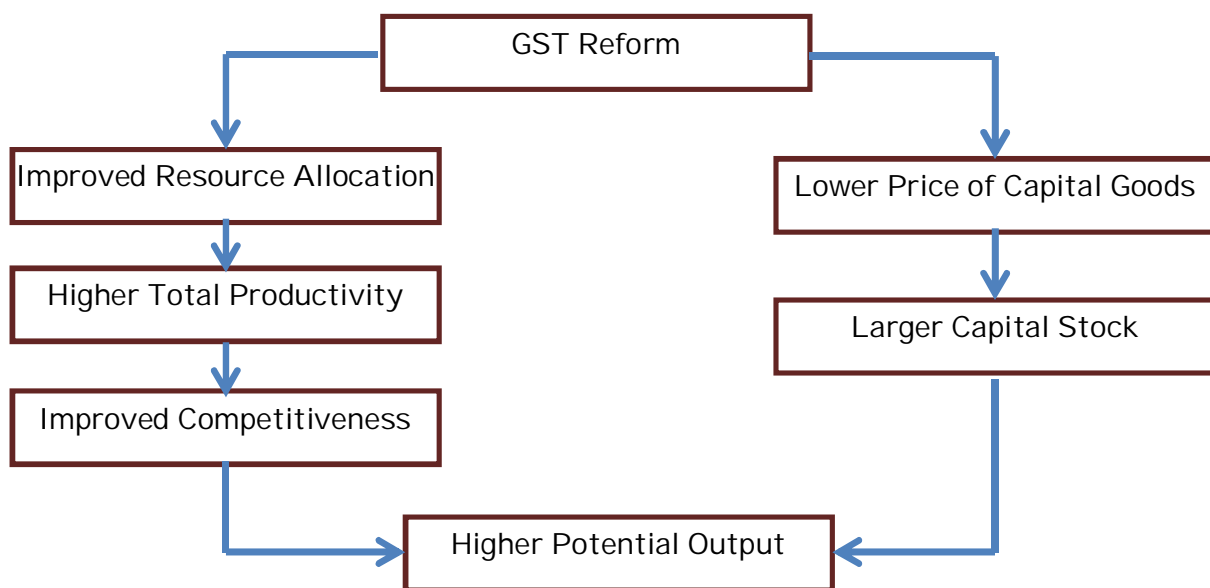


Figure 7.1 describes the main channel through which the general positive and productivity-enhancing effects of GST reform in India are likely to follow.

7.3 Textile Specific Effects of GST

The main effects of GST on textile producers and consumers can be divided into two parts: (a) the main effect arising from a likely increase in the effective rate of tax under GST as compared to the present domestic indirect taxes and (b) other subsidiary but positive effects. The first effect is being entitled as the rate revenue effect.

7.3.1 Rate-Revenue Augmentation Effect

GST rates cannot be commodity-specific. The lowest rates, as per present discussions, will be higher than the low textiles- specific RNRs presently being considered. As a result, in segments of textiles with low price-elasticity, any increase in the tax rates, will lead to higher revenues. The increase will be higher for goods and relatively even higher for services. Since services are used only as inputs in the case of textiles, this effect would be washed out as all input tax paid will be rebated.

We consider that the overall GST rate would be nearly 3 percentage points higher than the combined RNR for the textile sector considered as a whole. This will yield additional revenues both to the central government and the state governments. The additional revenues accruing to the state governments would be relatively higher. This follows directly from the fact that currently, after the withdrawal of the arrangement of levying additional excise duty in lieu of sales tax, the state governments have not levied the sale tax/State VAT on most textile outputs. This also explains why the textile sector is taxed at a lesser rate relative to other sectors or outputs. GST will only bring the textile sector on par with other sectors leading to a more neutral climate of investment across sectors thereby improving the overall resource allocation efficiency.

Segment wise effects will be different depending on the specific RNRs. Given the segment-wise textile specific RNRs and the GST rates, for those textile sectors where the RNR is lower than the GST rates, there will be an additional tax burden. For those textile segments, where the RNR is more than the GST rate, there will be a lower tax incidence compared to the present situation. Table 5.9 indicates that except for two segments, namely silk textiles and artificial silk and synthetic fibre textiles, all other segments have a low effective rate of tax and in all probability GST rates will be higher than the segment specific RNRs.

These disadvantages will have to be neutralized by placing these in the low rate categories (in case of a two-rate GST structure, which is likely for the States) and by appropriately redesigning the government support policies through subsidies and tax expenditures.

The higher tax incidence on textiles will translate into higher prices and an adverse effect on consumption, *ceteris paribus*. This may be partially absorbed by improvements in productivity. The overall effect of GST, considering the economy as a whole, as argued by the NCAER study, will be price reducing. This will partially absorb the price-increasing effect of GST on the textile sector. Since there is an implied price increase, we have studied the nature of demand for textile in India and how this will be impacted by the GST.

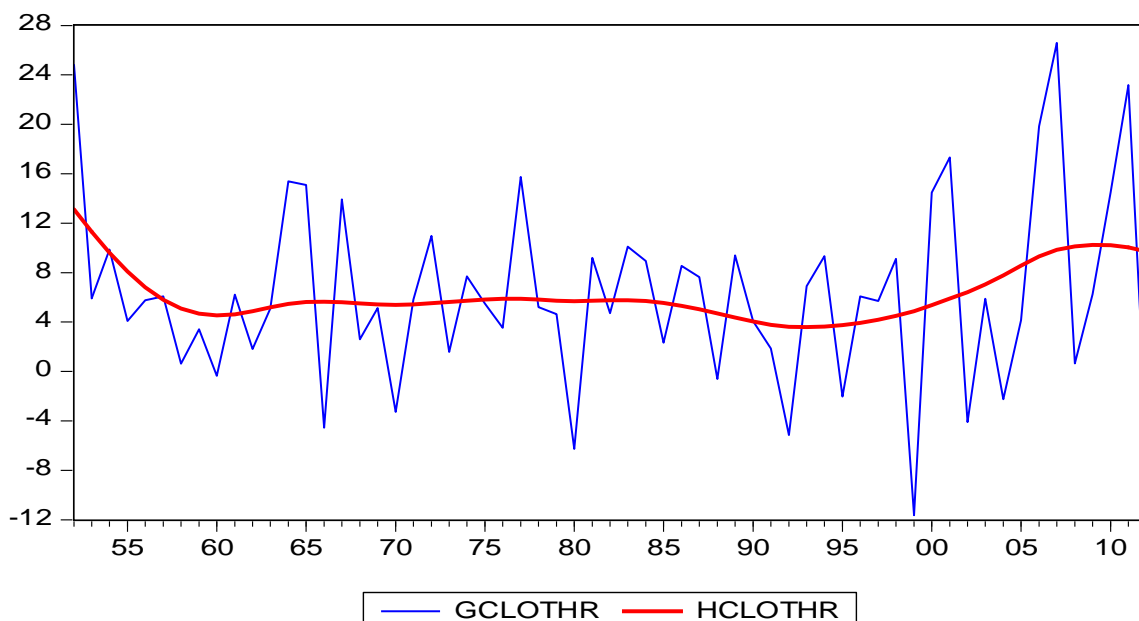
Oberoi (2013) in a recent study notes that the textile industry in India, which experienced a recession (earlier noted by Chandrasekhar 1984; Goswami 1990) from the mid-1960s to the 1980s when the per capita consumption for textile products almost stagnated. However, a significant increase in the per capita consumption of textiles reversed this trend after the early 1990s. She notes that the recent increase in demand for textiles (clothing) is due to both acceleration in the growth of per capita income and a fall in the price of textile products relative to other products.

She also provides an income inequality perspective on textile demand by arguing that while the growing demand for textiles and clothing since the early 1990s seems to be true of all expenditure groups, it was led by the rich and middle income groups. The increase in demand was mainly driven by the rising incomes and the fall in the prices of textiles. Lower prices of synthetic fibres and filament yarns due to tariff reductions resulted in an increase in their use by fabric producers and the increase in demand led to the expansion in the domestic capacities for producing synthetic fibres and filament yarns, which ultimately led to a much lower relative price of synthetic fabrics which were widely available domestically.

She also notes an inverse relationship between the prices of food-grains and demand for textiles that had been observed in the Indian economy during previous decades, does not seem to hold during the period since 1990-91. She argues that the increasing incomes and lowered prices of textiles have more than balanced the fall in demand for clothing due to increased prices of food-grains. It is for these reasons that the industry has experienced substantial growth and the pre-liberalisation trends in India's textile industry have been reversed during the liberalisation years.

In this study, we have re-examined the main features of textile demand in India over the period from 1951-52 to 2011-12 and the determinants of textile demand in India using data on private final consumption expenditure from the National Income Accounts data. Since these data are given in both constant (2004-05) prices and current prices, an implicit price deflator can be used to indicate both textile prices and the overall movement of prices.

Figure 7.2: Growth in Demand for Clothing and Underlying Trend through HP Filter



Note:

GCLOTHR: Growth rate consumption expenditure on clothing at 2004-05 prices

HCLOTHR: Consumption expenditure on clothing estimated through Hodrick-Prescott filter

Figure 7.2 shows the pattern of year-wise growth in private final consumption expenditure on clothing and the underlying trend captured through the Hodrick-Prescott filter. The underlying trend highlights that on trend basis the annual growth in demand for clothing fell from an average of close to 10 percent in the early fifties to a low of about 3.6 percent in the early nineties (the lowest point occurring in 1992-93 after which the annual growth picked up to increase to an average of more than 10 percent by 2008-09. It is also indicated that the amplitude of volatility around the trend has increased.

In identifying the determinants of demand, we examine the role of three determinants: real income, relative price (of clothing relative to all goods) and the price of food. All the variables have unit roots. The analysis is therefore done using a co-integrating relationship amongst real expenditure on clothing, real GDP and relative price of textile along with an error correction equation, which gives the short run relationship. All variables are transformed in logs and the coefficients can be interpreted as elasticities. Table 7.1 gives the long run relationship amongst the respective variables.

Table 7.1: Demand for Clothing: Long Run Equilibrium Relationship

Dependent Variable: LCLOTHR				
Method: Least Squares				
Sample: 1952 2012				
Included observations: 61				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.929	0.853	1.088	0.281
LPDYR	0.181	0.058	3.130	0.003
LPCLOTH-LPYMR	-0.226	0.102	-2.210	0.031
LCLOTHR(-1)	0.787	0.055	14.322	0.000
DD99	-0.189	0.061	-3.094	0.003
R-squared	0.996	Mean dependent var		10.615
Adjusted R-squared	0.996	S.D. dependent var		0.916
F-statistic	3480.36	Durbin-Watson stat		1.95

Variables:

CLOTHR: Final consumption expenditure on clothing at 2004-05 prices

PDYR: Personal disposable income

PCLOTH: Implicit price deflator of clothing (base 2004-05)

PYMR: Implicit price deflator of GDP at market prices

DD99: point dummy for 1998-99

Variable name preceded by L indicates logarithm of the variable.

Long-term demand for clothing, representing demand for textiles as a whole, moves in tandem with increase in per capita income and relative price of textiles. The response elasticities are picked up in the estimation of the short term dynamics. The error term indicated by the lagged value of the variable *zlclothr* indicates statistical significance of the error correction mechanism and the existence of the co-integrating relationship.

The income and price elasticities have the expected signs. The income elasticity (about 0.5) is higher in magnitude as compared to the price elasticity (about 0.3). These response coefficients indicate that any adverse impact of increase in textile prices on demand will be overtaken by the positive effect of GST on income. As argued earlier, GST will have both an income effect and a price effect.

The short term dynamics is captured by the following equation depicted in Table 7.2.

Table 7.2: Demand for Clothing: Short Run Dynamics: Error Correction Equation

Dependent Variable: DLCLOTHR				
Method: Least Squares				
Sample (adjusted): 1953 2012				
Included observations: 60 after adjustments				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.034	0.012	2.954	0.005
DLPDYR	0.498	0.181	2.753	0.008
ZLCLOTHR(-1)	-0.132	0.072	-1.831	0.073
DLPCLOTH-DLPYMR	-0.283	0.116	-2.433	0.019
DD77	0.115	0.047	2.465	0.017
DD99	-0.192	0.047	-4.114	0.000
DD101	0.136	0.046	2.936	0.005
DD107	0.179	0.049	3.655	0.001
DD111	0.188	0.048	3.962	0.000
DLCLOTHR(-1)	-0.223	0.098	-2.277	0.027
Adjusted R-squared	0.54	S.D. dependent var		0.07
S.E. of regression	0.05	Akaike info criterion		-3.20
F-statistic	8.82	Durbin-Watson stat		1.82

Variables:

As defined above in Table 7.1

Variable name preceded by D indicates first difference.

DD77 indicates point dummy for 1976-77; similarly for other years.

7.3.1.1 Price and Income Effects

Table 7.3 gives the estimated price and income effects and the net effect on demand of a move from the present system of domestic indirect taxes to a uniform GST rate of 12%. The parameters used for price and income elasticity for this purpose are as follows: price elasticity [(-) (0.28)] and income elasticity (0.5). These are based on estimates given in Table 7.2. These estimates pertain to the textile sector as a whole. A positive overall growth effect of 1.5% points is assumed. This is based on the NCAER study cited above. It may be noted that given the availability of data, it has not been possible to estimate differentiated price elasticities for different textile categories or substitution elasticities between them. The net effect is shown to be adverse for three sectors: Khadi and handloom, Cotton textile and Carpets. In terms of magnitude the largest effect is on Khadi and Handloom. In terms of relative importance in the tax base, the largest share is that of cotton textiles.

Table 7.3: Price and Income Effects

Category	Base price	Base+Present Taxes	Base+GST	Increase in price (%)	Change in demand (own price relative to all prices effect) (%)	Change in demand (income effect) (%)	Net Change in demand (%)
Khadi, cotton textiles (handlooms)	100	104.0	112	7.7%	-2.2%	0.8%	-1.4%
Cotton textiles	100	107.1	112	4.6%	-1.3%	0.8%	-0.5%
Woolen textiles	100	109.3	112	2.4%	-0.7%	0.8%	0.1%
Silk textiles	100	109.6	112	2.2%	-0.6%	0.8%	0.1%
Art silk, synthetic fiber textiles	100	110.2	112	1.6%	-0.5%	0.8%	0.3%
Jute, hemp, mesta textiles	100	109.0	112	2.8%	-0.8%	0.8%	0.0%
Carpet weaving	100	105.6	112	6.1%	-1.7%	0.8%	-1.0%
Readymade garments	100	110.5	112	1.4%	-0.4%	0.8%	0.4%
Miscellaneous textile products	100	112.0	112	0.0%	0.0%	0.8%	0.7%
Total	100	109.3	112	2.5%	-0.7%	0.8%	0.0%

Source: EY Estimates

Table 7.3 indicates that three textile sub-sectors are likely to be adversely affected in the transition from the present tax system to GST. These sectors are: Khadi and Handloom, cotton textiles and carpets. The domestic demand in the three cases is estimated to fall. The effect is largest for Khadi and Handloom and smallest for Cotton textiles. In order to cope with these changes, policy options within the GST framework (exemption, zero-rating) and outside the GST framework (subsidization along with the standard GST rate) and the implications of these options are discussed further in section 7.4. Since the effect of GST is on the price and therefore on the consumer, an important related issue concerns the equity implications of the transition to GST, which is discussed in the next section. The net effect on demand will also be positive on some segments, notably, miscellaneous textile products, readymade garments, artificial silk and synthetic fibre textiles. These differential impacts will induce substitution effects within the textile sector in consumption and production away from cotton textiles to man-made fibre based textiles. To the extent that the changes through substitution are absorbed within the textile sector, the overall net impact on the textile sector will be negligible as long as the GST rate is kept at 12 percent¹¹. If it increases above this level, the impact will be adverse.

¹¹ It may be noted that the 12 percent figure is with respect to the 2011-12 cenvat and statevat rates. In 2012-13 the cenvat rate was increased by 2 percentage points. Many states have also increased the lower and higher statevat rates, the former by one percentage point and the latter by 1 to 3 % points, in general. Appendix 10 elaborates further on the change in tax rates in 2012-

7.3.1.2 Equity Considerations

Since there is a positive overall price effect on textile items in a move to GST, there are important equity considerations that arise. Tables 7.4 and 7.5 give the share of expenditure for important necessities according to percentile class of monthly per capita expenditure respectively for rural and urban areas, respectively. As we move from lower to higher expenditure percentiles, the share of expenditure on basic food, fuel and light and clothing and bedding fall. For processed food it increases marginally as we move to higher expenditure percentiles. It increases more sharply as we move to higher expenditure percentiles for medical expenditures and other expenditures. This pattern is broadly the same for both rural areas and urban areas. Any increase in prices for basic food, fuel and light and clothing and bedding will have therefore a relatively more adverse effect on lower income groups as these items account for a relatively larger share of expenditure for the lower income groups. Within the list of these items, however, clothing and bedding accounts for the lowest percentile (about 7% for both rural and urban areas) and the difference from the average is also minimal. Thus the impact of any increase in prices of textile items would be limited although it will be regressive. Furthermore, in a fibre-neutral tax regime like the GST, the man-made fibre based fabrics will be benefitted relatively more and, depending on the GST rate, the price effect is likely to be negligible. In such a case, the adverse equity effect may be further mitigated by a progressive shift towards man-made fibre based textiles by the lower income groups.

Table 7.4: Pattern of expenditure on essential items in Rural India: Share of Monthly per capita expenditure

Fractile class	Percent						
	Basic Food	Processed Food	Fuel and light	Clothing & bedding	Medical	Other expenditure	Total
0-P5	52.9	7.7	12.4	7.4	3.1	16.6	100
P5-P10	52.4	7.8	11.4	7.2	3.8	17.5	100
P10-P20	52.7	7.6	10.6	6.9	4.0	18.2	100
P20-P30	51.7	7.5	10.2	6.7	4.7	19.1	100
P30-P40	51.1	7.8	9.5	6.6	4.7	20.4	100
P40-P50	50.1	8.0	9.1	6.6	4.9	21.4	100
P50-P60	49.3	7.7	8.8	6.6	5.4	22.2	100
P60-P70	47.8	7.9	8.4	6.2	5.5	24.2	100
P70-P80	46.4	7.8	7.9	6.0	6.4	25.5	100
P80-P90	44.0	7.8	7.4	5.8	7.2	27.8	100
P90-P95	39.9	7.7	6.6	5.5	8.7	31.6	100
>P95	30.8	8.7	4.5	4.4	11.0	40.5	100
All	45.0	7.9	8.0	6.0	6.7	26.5	100

Source: Based on Household Consumption Expenditure Survey, National Sample Survey Organisation 2012

13. Accordingly, the corresponding GST rate could be closer to 14 percent at which the net impact on demand for textile products as a whole may remain unaffected.

Table 7.5: Pattern of expenditure on essential items in Urban India: Share of Monthly per capita expenditure

Fractile Class							Percent
	Basic Food	Processed Food	Fuel and light	Clothing & bedding	Medical	Other expenditure	Total
0-P5	52.2	7.0	11.4	6.8	3.0	19.5	100
P5-P10	50.8	7.8	10.5	6.3	3.6	21.0	100
P10-P20	48.7	7.5	9.7	6.2	4.2	23.7	100
P20-P30	46.8	7.6	9.0	6.2	4.3	26.0	100
P30-P40	45.0	7.7	8.6	6.0	4.5	28.2	100
P40-P50	42.0	8.2	8.1	6.0	4.6	31.1	100
P50-P60	40.8	7.7	7.5	5.8	5.5	32.7	100
P60-P70	38.1	8.3	7.1	5.7	5.5	35.3	100
P70-P80	35.3	8.6	6.7	5.4	5.6	38.5	100
P80-P90	31.6	8.9	6.1	5.2	6.0	42.2	100
P90-P95	26.7	9.7	5.6	5.2	6.4	46.4	100
>P95	16.4	11.5	4.1	4.2	6.4	57.5	100
all	33.6	9.0	6.7	5.4	5.5	39.8	100

Source: Based on Household Consumption Expenditure Survey, National Sample Survey Organisation 2012

Subsidiary Positive Effects

The other effects arise from improvement in productivity, improved resource allocation and fibre-neutrality.

7.3.2 Fibre-neutrality Effect

Depending on how the GST is structured, it will treat all fibres in the same way whether cotton based or based on man-made fibres. Important substitution effects that will be induced in a fibre-neutral fiscal regime as compared to the present one, which gives relatively favourable treatment to certain segments like Khadi and handloom and cotton textiles. There will thus be adjustments within the textile sector even if the overall textile sector demand does not get affected by the transition to GST rate, as discussed below.

- ▶ The Handloom industry currently produces both low as well as high value added products. The uniform GST rate is likely to be significantly higher than the current effective tax rate of the Handloom industry. While demand for high value-add handloom products with low price elasticity can be expected to remain largely unaffected, low value-add handloom products with higher price elasticity may witness a fall in demand. Therefore, producers of low value-add handloom products can be expected to upgrade to the powerloom sector, resulting in increased productivity, quality and returns on investment. This can be classified as a process efficiency effect.
- ▶ The cotton textile industry presently has a lower effective tax rate as compared to the synthetic textile industry. The uniform GST rate is therefore likely to lead to higher increase in prices of cotton textiles as compared to synthetic textiles. As a

result, cotton textile manufacturers can be expected to increase blending of synthetic fibres with cotton fibres. This can be classified as the fibre-neutrality effect.

This will also lead to a product diversification effect where more blends and mixes of types of fibres can be encouraged.

7.3.3 Transparency Effect

In the present system, many textiles outputs are exempt and taxes paid on inputs are blocked. These are rebated, especially in the case of exports, through a variety of export promotion schemes and only partially through the tax system. Furthermore, when the inputs are non-textile inputs, the blocked input taxes are not collected from the textile dealers. Instead, these may be shown as paid by dealers of the concerned input, whether goods or services, although the tax will be loaded on the price of the textile product and paid by the textile consumer. In GST all input taxes will be rebated whether meant for exports or domestic use through the tax system. In the GST system, these taxes will be collected from the consumers of the textile products and shown as paid by the textile dealers. This will make the system of taxes as well as subsidies more transparent.

7.3.4 Export Zero Rating Effect

Under GST, exports will be fully and automatically zero-rated. This will cover all domestic taxation of inputs used for products that are exported. This will reduce the scope of duty drawback scheme considerably as all input taxes paid in regard to domestic indirect taxes, namely, central excise duties, service tax, state sales tax, inter-state sales tax, and entry tax which would have been merged in GST, will be rebated. Only customs duties paid on imported inputs used for textile exports may not be covered under GST although countervailing duty should be covered. The money that will be released from duty drawback scheme should then be used for supporting the sector.

7.3.5 Common Market Effect

With the abolition of the inter-state sales tax (central sales tax) and entry tax, the Indian market will become a genuine all-India market without fiscal barriers. Textile industry, where considerable transmission of both inputs and outputs takes place across states, will be one of the main beneficiaries.

7.3.6 Investment Promoting Effect

With taxes paid on purchases of machinery and equipment also being fully rebated, investors will be induced to modernize textile production by induction of modern machinery and equipment. This may be further facilitated by redesigning the Technology Upgradation Funds Scheme (TUFS).

7.3.7 Improved Compliance Effect

An important effect of GST would be to improve compliance. The value chain under the GST will be fully traceable. As a result, ITC claims will have to be backed by full

information chain of purchases and sales. Improved compliance will automatically lead to higher revenues for any given rate as long as that rate is not excessively high.

Subject to certain qualifications, we have estimated compliance gap in the textile sector to be in the range of 30-35 percent. With GST, there will be significant progress in filling up this compliance gap.

In summary, while the key concern remains the likely increase in tax burden from 9.3% to possibly 12%, which may lead to a reduction in demand for some textile products, the overall impact may not be negative as there would be greater efficiency in production, which may lead to downward movement of prices. Exports may go up due to true zero rating. Further, a major reform like GST will lead to higher GDP and higher disposable incomes and the Price and Income elasticity of demand may compensate for each other.

7.4 Policy Options for Textiles under GST

The overall impact of GST on the textile industry and consumers will depend on how the available policy options are exercised in implementing GST in relation to textiles. We have noted that the three segments that would be in a relatively disadvantageous position are: Khadi and Handlooms, Cotton textiles, and carpet weaving. The main policy options, which may be considered for specific segments or all segments of textiles, are as follows:

- ▶ Zero rating
- ▶ Exemption
- ▶ Lower rate of tax
- ▶ Standard rate of tax with appropriate subsidies

Zero rating other than for exports is not recommended although it is possible if all input taxes are refunded. Zero rating involves an effective mechanism for refunds and even advanced tax jurisdictions find it difficult to implement it. It should be recognized that zero rating will not cover producers below threshold levels. On the other hand, it may lead to rush for registration with the central and state governments to claim the refunds. It may also open up an avenue for claims that may be fraudulent.

In the case of exports, some input taxes on account of Petroleum products and Electricity remain uncredited under the present tax regime. They may remain uncredited if these items remain outside the GST. To ensure that exports remain truly zero rated, the Duty Drawback rates could be revised to account for input taxes which remain uncredited. However, increasingly such schemes will be challenged at the WTO.

- ▶ Exemption

The second option is exemption for selected segments. Exemption does not mean no incidence of tax since it results in blocked input taxes. It may result in higher tax incidence due to blocked input taxes and tax cascading. The tax impact of exemption becomes dependent on the nature of supply chain. For example, vertical integration may reduce the magnitude of block input taxes. This option is also not recommended as it distorts resource allocation choices. It shifts tax burden from consumption to production. Exemption to fabrics leads to pressure from industry for exemption from

production inputs as well. This leads to complexities in the administration of tax. In general, selective exemptions detract from the supply chain neutrality as well as fibre neutrality in the textile sector.

Under the GST scheme, area-based exemptions will be discontinued. Existing schemes may be grandfathered upto any committed time limit.

▶ Lower rate of tax

The next option is to subject the textile segments to the lower rate of tax, which may be possible in a dual rate regime. This is an advisable option if the government chooses to have a lower GST rate along with a standard rate. We also suggest that all textile fabric categories (e.g., khadi, cotton, synthetic, and ready-made garments) should be in the same category to avoid classification disputes and maintain fibre neutrality. However, the scope of lower tax rate needs to be determined. There will be issues if inputs are taxable at higher rate and outputs are taxable at the lower rate. It gives rise to issues relating to refunds and requires monitoring of refunds.

▶ Standard rate of tax with appropriate subsidies

Another option is to apply the standard rate of tax with appropriate subsidies. If the country goes for a single rate regime, this option may be recommended in preference to zero-rating and exemption even if there is a net positive effect on prices. However, the price effect of GST will depend on the actual level of the standard GST rate. A GST regime with a standard rate results in a clean tax system. It achieves production efficiency, which is the key concern as opposed to the regressivity of the tax system. It can be accompanied by an appropriate subsidy regime to support weakest segments of the textile industry. In the case of textiles, additional resources will be released to finance such subsidies as many of the existing support schemes will not be required once zero-rating of exports becomes integral to the tax system as under GST. A final view as to the relevant policy option can be taken once the design and rate structure of GST is decided.

7.4.1 Policy Options for Specific Textile Segments

7.4.1.1 Khadi and Handlooms

The handloom industry plays an important role in the country's economy, being one of the largest economic activities and providing direct employment to over 65 lakh people engaged in weaving and allied activities. The sector is a substantial contributor to the overall fabric production in India. The fabric production from handloom sector was 6.9 billion square metres in the year 2011-12, forming ~11% of the country's total fabric production. Majority of this production is consumed in the domestic market and a minor percentage of overall production gets exported.

Handloom products have always faced competition from power loom sector, where the cost of production is much lower. Slowly handloom industry has moved towards production of more value added products, where the price of the product is judged more by its aesthetic and heritage value. Silk Saree from Varanasi, scarf from Barabanki, home furnishing from Bijnore, shawls from Kullu, ikat sari from Sonapur and Bargarh, cotton saree from Chanderi are few such examples of value added handloom products.

Based on the RNRs, we have estimated a net effect on demand to be negative but the estimated magnitude is small at (-) 1.4. as given in Table 7.3. The majority of the

handloom products are value added products and we do not perceive any considerable market shrinkage of handloom product.

Zero rating can be one option to avoid increase of tax burden on handloom products. Zero rating is possible only if all input taxes are refunded. But it will be quite difficult to manage its administrative process. The zero rating policy option has been tried earlier by different jurisdictions, who have found it difficult to administer and monitor input tax refunds.

The other option is to subject it to the standard GST rate while facilitating the handloom weaving process through different interventions, which will help in decreasing the cost of production or increasing the value of product. Some of the possible interventions are mentioned below.

1. Raw material bank: Yarn constitutes more than 60% of the overall cost of handloom products. Typically major yarn spinners are not located within or near the handloom clusters and they do not sell yarn directly to the weaver/master weaver/cooperatives. There are a number of agents involved in the process of delivering the yarn from mill to weaver, which increases the price of yarn and sometimes creates artificial shortage of raw material availability, which in turn increases the price of yarn. Development of raw material (yarn) bank at a cluster level will not only ensure continuous supply of raw material but will also help in reducing the price of yarn.
2. Supply of handloom parts at subsidized rate: Many times handloom weavers can't change the defective handloom parts due to its high price. This reduces the efficiency level of the handloom weavers and also deteriorates the quality of the products. Supply of handloom parts at subsidized rate will help handloom weavers to improve their efficiency, which will help in reduction of cost of production. Also, an improvement in quality will enable the handloom weavers to charge a premium for their product.
3. Improved Dyeing facility: Color fastness is the most common quality problem with handloom products. Many consumers hesitate to purchase handloom products due to this problem. Usage of age old dyeing facility is the reason behind such quality problem. Installation of better dyeing technology at cluster level will help in solving this quality issue, which will help in increasing the demand of handloom products and its price as well.
4. Product & design development: Supporting handloom weavers in product and design development will help them in reducing the cost of manufacturing and developing higher value added products, which can be sold with higher premium. This facility can be provided to handloom weavers through training or opening facility centre at the cluster level.

It is important to mention here that Ministry of Textiles is implementing many such interventions through different schemes. The scale and coverage of those interventions might be expanded to improve its effect on overall handloom industry.

7.4.1.2 Cotton Textiles

Cotton textiles constitute a large part of the tax base. There will be some adverse effect on demand but the magnitude of the effect is likely to be small. Much of the impact will be absorbed within the textile sector by a relatively higher growth of productive activities within the man-made fibre based textiles segment and development of new blends. These changes will also lead to more employment including workers in the cotton textile sector if they are released from this sector.

7.4.1.3 Carpets

Carpets are largely exported. The part of the carpet industry that deals with exports will be benefitted with the zero-rating. The carpet prices in the domestic market may go up by a small margin. Since the main domestic consumers are from relatively better off households, offices and government departments, there is no strong case for not subjecting the carpet segment to the standard GST rate.

In exercising any of the options, it may be recalled that the three textile sectors that are slated to be relatively adversely affected are Khadi and handloom, cotton textiles and carpets. Even in these sectors, to the extent that the goods are exported, there will be zero-rating and the effects will only be beneficial. Furthermore, even for domestic sales, the adverse effect of increased prices will be largely on consumers given the low demand elasticity. As far as the producers are concerned there will be hardly any difference between zero-rating, where the input tax rebate will come from the general tax payers of all goods and services and GST at standard rate where the inputs to producers will come largely from the relevant textile consumers. The main consideration is therefore as to how demand within the textile categories will be affected, that is how significant and desirable substitution effects will be between Khadi and Handloom and cotton textile products vis-à-vis synthetic and man-made fibre based products. Such substitution is already happening and as the latter category products are cheaper, it will have a positive equity effects.

Chapter 8: Textile Industry: Preparing for Transition to GST

The textile industry in India is undergoing a major transformation in terms of product development and technological up-gradation. There is also increased competition to Indian exports from other major textile producers in the world; at the same time domestic producers have to compete with world supplies. In the context of GST, the policy support to the textile industry will also have to be redesigned taking into account constraints placed by the WTO restrictions.

8.1 Transformation of Fibre-Mix

A major transformation that is taking place in India is in terms of fibre mix. As noted by the National Fibre Policy (2010), covering the period, 2010-20, the domestic fibre consumption ratio in India at present is 41:59 (FY2009) between man-made fibres and cotton, while it is almost 60:40 globally. The global fibre consumption trend in future is likely to further tilt in favour of man-made fibres as there is a limitation to growth of cotton worldwide on account of limited availability of land for cotton cultivation. Given that the future demand is expected to be largely in favour of man-made fibre based textiles, special attention is required to boost the consumption and production of man-made fibres in India.

As enunciated in the draft paper on national fibre policy, the National Fibre Policy has the following aims and objectives:

- ▶ Augmenting investment and providing support on both fiscal and non-fiscal front to increase fibre availability in the country and facilitate high growth and competitiveness of the textile sector;
- ▶ Focusing on improving quality of the fibre produced in India;
- ▶ Devising means to augmenting remuneration of all the stakeholders within the fibre eco-system;
- ▶ Correcting fiscal anomalies and policy limitations that are currently present in the fibre eco-system in order to ensure balanced growth of the textile industry;
- ▶ Providing assistance for building capacity in both industry segments and human capital required for processing the expected surge in the fibre production;
- ▶ Supporting modernisation and technological up-gradation of various segments of the industry, to increase its competitiveness; and
- ▶ Addressing the problem of infrastructure bottlenecks.

The key elements of the National Fibre Policy thus include the following:

- ▶ Cotton production is envisaged to rise at a growth rate of 4.7 percent from 319 lakh bales in 2010-11 to 483 lakh bales in 2019-20; Cotton Consumption is envisaged to increase to 413 lakh bales by 2019-20 with 70 lakh bales being surplus;
- ▶ For Man Made Fibres and Specialty Fibres, domestic demand is expected to rise at a growth rate of 8 percent per annum from 3.9 billion kgs in 2015 to 6 billion kgs in 2020;
- ▶ Jute production will rise at a growth rate of 3.6 percent from 94 lakh bales in 2010-11 to 130 lakh bales in 2019-20;
- ▶ Wool consumption is projected to more than double from 114.2 million kgs in 2009-10 to 260.8 million kgs in 2020.

India's current strength lies in the production of cotton yarn, which accounts for around 74% of total spun yarn production in India. The production of cotton yarn in India has recorded an annual average growth rate of around 6.5% during FY2005 to FY2009. The dismantling of Multi fibre Agreement (MFA) in 2005 has provided a boost to India's yarn exports. India is a net exporter of cotton yarn.

India manufactures a large variety of fabrics, with a range of finishes, width, and designs. India's fabric production is mostly in the form of cotton or blended fabric. However, non-cotton fabric has gained prominence during the last 15 years, and currently accounts for about 37.9% of country's total fabric production.

At the time of independence, the mill sector was the main producer of fabric in India. However, the growth of the power loom and handloom sectors, aided through government incentives, has led to a steep decline in the share of the mill sector in India's overall fabric production. The share of mill sector in fabric production has gone down from over 70.0% in the 1950s to less than 6.0% in FY97 and to a mere 3.3%, currently. On the other hand, fabric production in power-loom and handloom sectors has grown considerably; currently, these account for about 74.4% of India's total fabric production. The production of knitted fabrics in the hosiery segment has also increased in recent times; currently, hosiery accounts for 22% of total fabric production in India. The slowdown in the global economy from 2007 to 2009 impacted the growth of textiles industry in India.

Huge additional capacities are required in the man-made fibre industry in the wake of future demand. However, the MMF industry is capital intensive with a long gestation period. Thus, it is desired that incentives are provided to the industry to accelerate the process of capacity build-up, to ensure adequate supply of fibres to the user industry.

At present, TUFS is not applicable to manufacture of synthetic fibres as the sector falls under the ambit of Department of Chemicals and Petrochemicals. If TUFS is available to manufacturers of synthetic fibres as well, it would aid in reducing the capital cost and hence the capital servicing charges such as depreciation and interest on debt taken for capital equipment purchase.

8.2 Input-Neutral Fiscal Regime

The future of potential policy support would also depend on the constraints emanating from the WTO. Overtime, India would be asked to roll back policies that are designed to benefit specific sectors or products. Most policy support will have to be designed in a manner such that benefits are common to all manufacturing segments or sectors and not specific to particular products. Schemes like TUFS and Product Focus Schemes will have to be redesigned such that the benefits are available in a more common way.

Thus, both the taxation regimes and subsidy regimes will progressively become product neutral and input-neutral. These changes will automatically lead to input and technology choices that aim to maximize efficiency rather than take advantage of fiscal benefits. Thus, the input-neutrality of tax and subsidy regimes will be particularly beneficial to the textile industry given the need to move to a fibre-neutral export oriented future.

GST is likely to automatically provide a fibre-neutral taxation policy subject to the condition that tax paid on petroleum inputs used in the production of MMF are rebated. This would eliminate the historical discrimination of man-made fibres and textiles against cotton and cotton textiles in the form of higher excise duties. Automatic zero-

rating of exports under GST will ensure that no input taxes are embedded in the price of man-made fibres making these internationally more competitive.

TUFS can be made more general in application encouraging capacity expansion and up-gradation of machinery. At present, TUFS is available to the textile industry for up-gradation of machinery. However, under TUFS, all the segments of the textile industry including VSF and VFY are covered except manufacturing of synthetic fibres and yarn (i.e., PSF, PFY, NFY, ASF, PPSF, PPFY etc.) as the latter is administered by the Ministry of Chemicals and Petrochemicals. Given that man-made fibres are used by the textiles industry, incentives provided to MMF industry for technological up-gradation will ultimately benefit the user industry. The coverage under TUFS will result in attracting more investments, entry of more players, increasing the availability of MMF at competitive prices.

8.3 GST: Government and Industry Preparations

Both the government (textile ministry and state textile departments) and textile industry should prepare for the transition to GST. Adequate preparation for the implementation of GST, not only by the central and state governments, but also by the industry, that is producers, wholesalers and retailers is a prerequisite for the success of GST in India. Dealing with the input tax rebate system in central excise, service tax, and sales tax has prepared the ground somewhat but much needs to be done when input tax rebate chain has to run full circuit in CGST chain, SGST chain, and IGST.

The key aspects for the industry under GST will involve the following:

- ▶ Registration of dealers through a common GSTN Portal:
 - ▶ Provision of a unique GSTN number operational throughout the chain of transactions
 - ▶ Dealing with central government's tax authority (CBEC), Finance Departments of State Governments, designated banks, and other dealers registered on the portal
- ▶ Suitable GST IT interface for the Indian system of dual taxation
- ▶ Options that can be given to dealers:
 - ▶ Periodicity of filing returns – monthly, bi-monthly, quarterly
 - ▶ Basis of settling accounts – payment, invoice, or hybrid
- ▶ Clarity needed in design of returns to show:
 - ▶ Whether supplies are exempt
 - ▶ Whether supply is of a good or service, sale of land or asset
 - ▶ Whether supplies are zero-rated

Whether the supply involves inter-state transaction, and if so, clear identification of origin and destination state.

There are three key aspects of this preparation: (a) dealer registration; (b) establishing the input tax rebate chain in CGST and SGST separately, and (c) division of IGST revenue across states from the centre. For this purpose the information compilation and processing methodology and rules for determining origin and destination in the case of goods and more importantly services are going to be important. Three main constituents in preparing for the implementation of GST are: Handling IGST, Place of Supply Rules, and the IT strategy.

Registration: A unique ID is necessary to identify each taxpayer. The PAN based ID should be common to both the states and the centre. A common PAN-based taxpayer registration has several benefits including a unified view of taxpayers for all tax authorities. A PAN based registration system has already been implemented in CBEC and several states are also capturing PAN data.

Returns: The states as well as the centre require taxpayers to file periodic returns to assess whether the taxpayers have computed, collected, and deposited their taxes correctly. ITC credit can also be verified on the basis of the returns filed and revenues reconciled against challan data from banks.

Challans: Challans are the payment instruments used by taxpayers to actually pay their taxes. Challans are deposited at collecting banks and are forwarded by them to the tax administrations.

IGST: Under GST, inter-state trade will be leviable to IGST. Under IGST, the tax paid by the selling dealer in the exporting state will be available as ITC to the purchasing dealer in the importing state. This requires verification of ITC claims and transfer of funds from one state to another. Further, in an interstate business to consumer transaction, tax collected in one state has to be transferred to another state as finalized by the business processes. Thus, periodic inter-state settlement is required.

Invoice level detail is necessary for the reconciliation of tax deposits, and the end-to-end reconciliation of ITC. An effective IGST implementation may also require invoice-level details. A number of states are capturing invoice details even in the existing VAT systems. A two-pronged approach with Dealer level granularity of returns is being proposed in the first phase followed by invoice level in the next phase.

Like the governmental level IT preparation there should correspondingly be industry level IT preparation. The IT transition from the VAT structure to GST structure, which should in principle be simpler, should be planned the detail. A typical dealer will be concerned with preparing the interface covering suppliers of goods and services, buyers of goods and services, state governments and the central government.

As per the recommendations of the IT Taskforce, the main links in the GST IT network will be between five major participants/groups of participants. The Common Tax portal will work as a clearing house. Each agency/government will have to deal with only the common tax portal.

Industry/dealers will have to register with Common Tax Portal. They will be identified with a GSTN number. They will deal the central government's tax authority (CBEC) which will also be the IGST authority, Finance Departments of State Governments, designated banks, and other dealers registered with Common tax portal. Throughout

the country, the same registration number will operate for all participants in the chain of transactions.

Correspondingly, each dealer or industry will have to develop its own IT interface. The entire record-keeping can become automated through the development of suitable GST software suitable for the Indian system of dual taxation, which should have the relevant return forms for declarations. Dealers can be given the option to choose the periodicity for filing returns. A one-month option may be suitable for those with frequent transactions. A six month periodicity may be chosen by those that undertake a limited number of transactions and do not want to go through the hassle of filing returns too frequently. Most dealers may settle for a two month cycle (odd months or even months). A dealer will need to distinguish between the supply channel, where input tax credits are to be claimed and sale channel where tax has to be paid. A cash book describing date-wise purchases of supplies of goods and services, identifying the location of supplier including the state, date of transactions, unit price, tax already paid on the supply, the recipient governments of such tax (centre and concerned state), invoice number, etc. Similarly, sales of the products have to be recorded. A consolidated return in the approved format has to be prepared for the agreed time cycle, showing claimed rebates, assessed tax, recipient tax authority, and net tax paid to the credit of the centre under CGST/IGST and states in the designated banks. The GST Portal should settle claims of rebates and issue advices to credit tax to the central and state accounts to the Reserve Bank of India.

Once GST is implemented, workshops should be regularly held to train dealers in keeping records in suitable formats for electronic return filing.

Chapter 9: Conclusions

Goods and Services tax (GST) constitutes the last mile of a long journey of reforms of indirect taxes in India. GST will replace a number of central and state taxes. The important taxes that may be subsumed in GST are Cenvat and service tax at the central level and State VAT/sales tax, central sales tax, and entry tax at the state level along with a number of additional or special duties and cesses and surcharges. The final design of the GST and the related constitutional amendment are yet to be finalized. However, the impact of GST on the textile sector will be quite significant.

GST will fundamentally change the way the textile sector is presently taxed in India. Taxation of textile sector is presently opaque and non-neutral across its various segments. Many textile outputs are either exempt under the central and state tax regimes or are subjected to relatively low tax rates. Most of the indirect taxes fall on inputs, both goods and services, and therefore remain hidden. GST will result in transparency; shifting of tax burden on to the final consumer; full rebating of tax paid on inputs and capital used for the production of textiles; and a fibre-neutral tax regime. Depending on the GST rates that are finally determined, it may result in a higher tax burden on textiles. But the resultant impact on demand may be small. On the other hand, textile production will become more competitive; better technology, improved productivity, more balanced fibre mix, more innovative products and more competitive exports may overtake any adverse effect of GST, which should also be neutralized through a recasting of the subsidy regime.

Although textile exports have grown, the share of textile exports in total Indian exports has steadily fallen. Indian textile exports face stiff competition from China and other countries. Higher costs, lower share of man-made fibres in the overall product mix, and less innovative products work as constraints on Indian textile exports. WTO rules also are becoming more serious constraints.

9.1 Current Tax Scenario

In spite of reforms, the current domestic indirect tax regime suffers from various inefficiencies.

Taxation of inputs and capital goods created a huge cascading impact on the industries. High and multiple tax rates coupled with exemptions and concessions further add to the complexities. Also, taxation of inter-State sales and lack of harmony in the states' sales tax/State VAT systems has encouraged harmful inter-state competition and tax evasion.

Thus, in spite of a long sequence of reforms of the domestic indirect taxes, various problems remain. The system of VAT is at present segmented between Cenvat, State-VAT, Central Sales tax, Entry tax, Service tax, and a variety of other taxes at the state level. Several problems continue with each segment of the system of taxation of goods and services as summarized below.

- ▶ In the case of Cenvat, the issues relating to definition of manufacturing and methodology of valuation remain causing difficulties in implementation of the tax.
- ▶ The problem of multiple rates remains although the tax rate structure is simpler than what it used to be. This leads to various classification disputes.
- ▶ In the case of service taxation, problems relate to distinguishing between a good and a service. The distinction between the two is often blurred.
- ▶ Exclusion of services from the tax base of the states potentially erodes their tax-buoyancy in a growing economy that is service-sector centric.
- ▶ Cascading has not been fully eliminated as there is cross cascading between State VAT, Cenvat, and the service tax.
- ▶ The Central sales tax continues to cause artificial inter-state tax borders. It constrains achieving the objective of a destination based system of taxation of goods and services.

9.2 Emerging Contours of GST

Many of these problems can be addressed by extending the scope of taxation of services for the states and the scope of taxation of goods up to the retail stage for the centre. Considerable discussion has already taken place as to a suitable design and administrative framework for GST. While, it has not been possible to resolve all the differences, significant progress has been made.

The present position is that the central government has come out with a revised draft of the Constitution Amendment Bill (2013) after receiving the report of the Parliamentary Standing Committee on the earlier Constitution Amendment Bill (2011). Certain contours of the GST have emerged clearly while there are some critical aspects on which decisions will have to be taken by the proposed GST Council.

GST will be a concurrent GST where the central and State governments will share a common tax base consisting of the value added of goods and services in the production and sale of goods and services. The significant features of GST are likely to be as follows:

1. The GST will have two components: one levied by the Centre (CGST) and the other to be levied by the States (SGST). The basic features of law such as chargeability, definition of taxable event and taxable person, measure of levy including valuation provisions, basis of classification etc. should be uniform across these statutes as far as practicable.
2. The CGST and SGST would be applicable to all supply of goods and services made for a consideration except for the exempted goods and services, goods which are outside the purview of GST and the transactions which are below the prescribed threshold limits.
3. The CGST and SGST are to be paid to the accounts of the Centre and the States separately. Taxes paid against the CGST and SGST will get input tax credit (ITC) within the CGST and SGST chains respectively but cross utilization of ITC between CGST and SGST would not be allowed.
4. The administration of the CGST will be with the centre and that of SGST with the states.
5. The following Central Taxes are likely to be subsumed under the GST: (i) Central

Excise Duty, (ii) Additional Excise Duties, (iii) Excise Duty levied under the Medicinal and Toiletries Preparation Act, (iv) Service Tax, (v) Additional Customs Duty, commonly known as Countervailing Duty (CVD), (vi) Special Additional Duty of Customs (SAD), (vii) Surcharges, and (viii) Cesses.

6. The following State taxes and levies should be, to begin with, subsumed under GST:
 - (i) VAT / sales tax, (ii) entertainment tax (unless it is levied by the local bodies, (iii) luxury tax, (iv) taxes on lottery, betting and gambling, (v) State cesses and surcharges in so far as they relate to supply of goods and services, and (vi) entry tax not in lieu of Octroi.

As far as Petroleum products, namely, crude, motor spirit (including ATF) and HSD would be kept outside GST as is the prevailing practice in India. Sales Tax could continue to be levied by the States on these products with prevailing floor rate. Similarly, Centre could also continue its levies. Alternatively, petroleum products may also be included in the scope of GST with the provision of a non-rebatable excise/sales tax over and above the standard rate of GST.

There is still some uncertainty as to the form of GST that will eventually be implemented. The Empowered Committee of State Finance ministers is presently considering the revised draft of the constitution amendment bill (2013) prepared by the central government after receiving the report of Parliamentary Standing Committee on Finance on the earlier constitution amendment bill (2011) regarding GST. The main features of the revised constitution amendment bill are summarized below.

A Goods and Service Tax Council (GST Council) will be constituted under article 279 A. The GST Council will decide on the following issues:

- ▶ Taxes, cesses and surcharges levied by the centre, the states and the local bodies that are to be subsumed in GST;
- ▶ The goods and services that may be exempted from GST;
- ▶ The threshold limit of turnover below which goods and services may be exempted from GST;
- ▶ The rates including floor rates and bands for GST;
- ▶ Any special rate or rates for a specified period to raise additional revenue during any natural calamity or disaster;
- ▶ Special provisions with respect to the States of Arunachal Pradesh, Assam, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura;
- ▶ Any other matter relating to the GST as the Council may decide.

The GST Council is to be guided by the need for a harmonized structure of the goods and services tax and for the development of a harmonized national market for goods and services.

A number of key issues have been left for the GST Council to decide. Major unresolved problems relate to determination of GST rates (CGST and SGST rates), threshold levels, treatment of petroleum products and other demerit goods (alcoholic beverages and tobacco products), mechanism for taxing inter-state sales, and the list of exempted goods and services.

9.3 Estimation of Revenue Neutral Rates

Revenue neutral rates may be calculated for the central government and state governments, separately and jointly. In this exercise, the effort is to find out the GST rate, composed of the CGST and SGST rates, which would raise the same amount of revenue as is presently being raised under the taxes that are to be merged into the GST.

Given the importance of blocked input taxes, the use of the input-output table, the latest version of which relates to 2007-08, is an important component of the methodology used here. This permits a study of nine textile segments where textile outputs are involved. These nine segments are indicated below:

- ▶ Khadi and handlooms
- ▶ Cotton textiles
- ▶ Woollen textiles
- ▶ Silk textiles
- ▶ Art silk and synthetic fibre textiles
- ▶ Jute, hemp, and mesta textiles
- ▶ Carpet weaving
- ▶ Ready-made garments
- ▶ Miscellaneous textile products

The RNR calculations are done with reference to 2011-12 data.

If we look only at the RNR with respect to output taxes paid by the textile dealers, it is very low. An appropriate comparison would be between potential tax revenue attributable to the textile sector that includes output tax and blocked input taxes applied on an estimated base under the present tax system and the potential revenue under GST estimated by applying a GST rate on an estimated base. In this comparison, the RNR comes out to be 9.3%. The RNR for the central taxes is 5.4 and that for state taxes is 3.9. This is still much lower than 12 %, which might be the lowest rate (6% CGST and 6% SGST) in the dual tax regime. We conclude therefore that for the textile sector considered as a whole the movement to GST will lead to additional tax burden. If the GST rate is fixed at 12%, effectively the tax rate will increase by a margin of a little above 30 percent.

RNRs are highest for the miscellaneous textile products and the readymade garments segments and relatively lower for the handloom, carpet weaving and cotton textile sectors.

In deciding a suitable form of GST for textiles, issues as to whether some segments can be exempted or whether selective concessions may be given often arise. It may be remembered that any exemptions or selective concessions would block input taxes, which will remain hidden as at present. What can be unambiguously argued is that if there is one single GST rate (CGST+SGST), it would suit the textile industry that this rate is kept as low as possible. If there is a dual rate, textiles should be placed at the lower rate.

9.4 Implications of GST for the Textile Industry

The main implications of GST compared to the present domestic indirect tax regime in the context of Textiles can be divided into two parts: (a) main and immediate effect, which may be adverse in nature and (b) other longer term positive effects.

Main Effect: Rate-Revenue Effect

Since the CGST and SGST rates are likely to be higher than the corresponding textile sector RNRs; the textile prices would go up. This will adversely affect demand for textile products. Our estimates based on time series on private final consumption expenditure on clothing shows that demand elasticity with respect to implicit price deflator of clothing relative to implicit price deflator of all goods is low (about 0.3). Therefore the magnitude of effect will be low. This will be further mitigated because estimates indicate that GST will have an overall positive income effect. Demand for clothing is also income elastic and the magnitude of estimated income-elasticity is somewhat higher at 0.5. Furthermore, since the demand elasticity is less than one, the fall in quantity demanded will be less than the increase in prices due to the rate increase resulting in higher revenues.

Other Positive Effects

Some of the longer term positive effect would be as follows.

- ▶ GST is likely to have a fibre-neutral rate structure unless differentiation is introduced by explicit choice (Fibre Neutrality Effect);
- ▶ Textile outputs will be taxed if domestically consumed and input taxes paid will be rebated making the tax-regime transparent (Transparency Effect);
- ▶ Exports will be zero-rated and all input taxes paid will be rebated by the tax authorities making duty drawback kind of schemes redundant (Export Zero-rating Effect);
- ▶ Fiscal barriers to inter-state movement of textile inputs and outputs like the CST and the entry tax will be eliminated (Common Market Effect);
- ▶ Taxes on capital and machinery will be fully rebated (Investment Promoting Effect); and
- ▶ For the industry, compliance costs will be lower (Compliance Promoting Effect).

Hence, all effects other than the augmented first will have a positive effect on the industry. The augmented revenue effect through a hike of tax rates under GST, will have an adverse effect as it would lead to a price increase. However, given that part of the textile products constitute goods of mass consumption, this adverse effect will have to be neutralized partly through the higher productivity linked to GST (through better resource allocation and infusion of new technology) and partly through adequate policy recasting using the additional revenues that the central and state government may earn.

GST rates cannot be commodity-specific. We consider that the overall GST rate would be nearly 3 percentage points higher than the combined RNR for the textile sector considered as a whole. This will yield additional revenues both to the central government and the state governments. The additional revenues accruing to the state governments would be relatively higher. This follows directly from the fact that currently, after the withdrawal of the arrangement of levying additional excise duty in

lieu of sales tax, the state governments have not levied the sale tax/State VAT on most textile outputs.

Segment wise effects will be different depending on the specific RNRs. Given the segment-wise textile specific RNRs and the GST rates, those textile sectors where the RNR is lower than the GST rates, there will be an additional tax burden. For those textile segments, where the RNR is more than the GST rate, there will be a lower tax incidence compared to the present situation. Except for two segments, namely silk textiles and artificial silk and synthetic fibre textiles, all other segments have a low effective rate of tax and in all probability GST rates will be higher than the segment specific RNRs.

Depending on how the GST is structured, it will treat all fibres in the same way whether cotton based or based on man-made fibres. This effect will depend on how petroleum inputs that go into manmade fibres will be treated. In particular, if petroleum products are part of the GST and all taxes on inputs into petroleum products and products made from refined petroleum are fully rebated, the taxation regime will become fully fibre-neutral. If there are some products where input taxes are not rebated, there will be some relatively larger tax burden on the man-made fibres even in the presence of GST.

Under GST, exports will be fully and automatically zero-rated. This will cover all domestic taxation of inputs used for products that are exported. This will reduce the scope of duty drawback scheme considerably as all input taxes paid in regard to domestic indirect taxes, namely, central excise duties, service tax, state sales tax, inter-state sales tax, and entry tax will be rebated. The money that will be released from duty drawback scheme should then be used for supporting the sector.

With the abolition of the inter-state sales tax (central sales tax) and entry tax, the Indian market will become a genuine all-India market without fiscal barriers. Textile industry, where considerable transmission of both inputs and outputs takes place, will be one of the main beneficiaries.

With taxes paid on purchases of machinery and equipment also being fully rebated, investors will be induced to modernize textile production by induction of modern machinery and equipment. This may be further facilitated by redesigning the Technology Upgradation for Textiles (TUFS) scheme.

An important effect of GST would be to improve compliance. The value chain under the GST will be fully traceable. As a result, ITC claims will have to be backed by full information chain of purchases and sales. Improved compliance will automatically lead to higher revenues for any given rate as long as that rate is not excessively high.

Subject to certain qualifications, we have estimated compliance gap in the textile sector to be in the range of 30-35 percent. With GST, there will be significant progress in filling up this compliance gap.

The final GST rates have not been decided yet. It may be said that if a dual GST rate structure is adopted, it will be beneficial for all the textile segments to be placed at the lower rate. This will enable all input taxes to be fully rebated. In general, exemptions should be avoided since these will imply un-rebated input taxes. The industry should also plead for avoiding the higher rate in a dual rate GST structure for any of its segments since that will adversely affect prices and demand.

9.5 Prospects and Policy Support

Cotton consumption has witnessed a sustained increase since 2003-04 due to the growing demand for Indian cotton textiles and subsequently, there has been considerable expansion and modernisation of the textile mills. Even though the Indian cotton consumption has increased at a rapid pace in the last few years, it has not kept pace with the growth in domestic cotton production, which has led to a surplus of production since 2003-2004. As a result, India has emerged as one of the top exporters of raw cotton in the world. Currently, India is the second-largest exporter of cotton after the US.

India is also the second largest producer of man-made fibres (MMF) also. However, India's share in global exports of value-added textiles of manmade fibres is miniscule at around 2.25% in 2008 (India's MMF exports were US\$ 3.3 billion as against global exports of US\$ 146.7 billion). Hence, the domestic MMF cotton fibre consumption ratio in India is 41:59 (FY09) while it is the reverse globally. The share of man-made fibres in total fibre consumption has risen from 25% in the early nineties to 41% at present. However, since the quota abolition, the share of MMF in India's fibre consumption has almost stagnated at around 40% on account of rising cotton production and international demand for cotton by textile manufacturers to cater to export demand from global markets.

India has a number of schemes for rebating or subsidizing textile exporters. These include duty drawback schemes, which aim at promoting exports by seeking to rebate duty or tax chargeable on any imported/excisable goods and input services used in the manufacture of export goods. The duties and tax neutralized under the scheme are (i) Customs and Union Excise Duties in respect of inputs and (ii) Service Tax in respect of input services. The Duty Drawback is of two types: (i) All Industry Rate and (ii) Brand Rate.

There are also duty credit scrips. Under these schemes specified products and specified sectors are incentivised by way of Duty Credit Scrips ranging from 2% to 5%. The Duty Credit may be used for import of inputs or goods including capital goods, provided the same is freely importable under ITC (HS). Additional customs duty/excise duty paid in cash or through debit under this scrip is adjusted as CENVAT Credit or Duty Drawback.

Increasingly, most of these schemes are falling on the wrong side of WTO restrictions. Apart from Duty Drawback and Export Oriented Units most of the other schemes do not conform to the Agreement on Subsidies and Countervailing Measures and can be potentially countervailed against, if not already done.

Under GST, zero-rating of exports would imply that most of these schemes would not even be necessary.

The resources that are released should be used for designing schemes that are applicable across different industries. In particular, TUFS should be extended also to man-made fibres. At present, this is not covered as it comes under a different ministry. This is discussed in the next section.

9.6 Preparing for Transition to GST: Textile Industry

The textile industry in India is undergoing a major transformation in terms of product development and technological up-gradation. There is also increased competition to

Indian exports from other major textile producers in the world; at the same time domestic producers have to compete with world supplies.

A major transformation that is taking place in India is in terms of fibre mix. As noted by the National Fibre Policy (2010), covering the period, 2010-20, the domestic fibre consumption ratio in India at present is 41:59 (FY2009) between man-made fibres and cotton, while it is almost 60:40 globally. The global fibre consumption trend in future is likely to further tilt in favour of man-made fibres as there are limits to growth of cotton worldwide on account of limited availability of land for cotton cultivation. Huge additional capacities are required in the man-made fibre industry in the wake of future demand. However, the MMF industry is capital intensive with a long gestation period. Thus, it is desired that incentives are provided to the industry to accelerate the process of capacity build-up, to ensure adequate supply of fibres to the user industry.

At present, TUFS is not applicable to manufacture of synthetic fibres as the sector falls under the ambit of Department of Chemicals and Petrochemicals. If TUFS is available to manufacturers of synthetic fibres as well, it would aid in reducing the capital cost and hence the capital servicing charges such as depreciation and interest on debt taken for capital equipment purchase. Thus industry players want certain allocation of funds under TUFS for synthetic fibre manufacturing.

Overtime, India would be asked to roll back policies that are designed to benefit specific sectors or products. Most policy support will have to be designed in a manner such that benefits are common to all manufacturing segments or sectors and not specific to particular products. Schemes like TUFS and Product Focus Schemes will have to be redesigned such that the benefits are available in a more common way.

Thus, both the taxation regimes and subsidy regimes will progressively become product neutral and input-neutral. These changes will automatically lead to input and technology choices that aim to maximize efficiency rather than take advantage of fiscal benefits. Thus, the input-neutrality of tax and subsidy regimes will be particularly beneficial to the textile industry given the need to move to a fibre-neutral export oriented future.

Both the government (textile ministry and state textile departments) and textile industry should prepare for the transition to GST. Adequate preparation for the implementation of GST, not only by the central and state governments, but also by the industry, that is producers, wholesalers and retailers is a prerequisite for the success of GST in India. Dealing with the input tax rebate system in central excise, service tax, and sales tax has prepared the ground somewhat but much needs to be done when input tax rebate chain has to run full circuit in CGST chain, SGST chain, and IGST. There are three key aspects of this preparation: (a) dealer registration; (b) establishing the input tax rebate chain in CGST and SGST separately, and (c) division of IGST revenue across states from the centre. For this purpose the information compilation and processing methodology and rules for determining origin and destination in the case of goods and more importantly services are going to be important. Three main constituents in preparing for the implementation of GST are: Handling IGST, Place of Supply Rules, and the IT strategy.

ANNEXURES

Annex 1: Customs Duty

The objective of Customs duty levied through the Customs Act formulated in 1962 is to prevent illegal imports and exports of goods. Besides, at the time of its formulation, all imports were sought to be subject to a duty with a view to affording protection to undeveloped indigenous industries as well as to keep the imports to the minimum in the interests of securing the exchange rate of Indian currency. Duties of customs are levied on goods imported or exported from India at the rate specified under the customs Tariff Act, 1975 as amended from time to time or any other law for the time being in force. Under the custom laws, the various types of duties that are leviable are:

- (1) Basic Duty: This duty is levied on imported goods under the Customs Act, 1962.
- (2) Additional Duty (Countervailing Duty) (CVD): This is levied under section 3(1) of the Custom Tariff Act and is equal to excise duty levied on a like product manufactured or produced in India. If a like product is not manufactured or produced in India, the excise duty that would be leviable on that product had it been manufactured or produced in India is the duty payable. If the product is leviable at different rates, the highest rate among those rates is the rate applicable. Such duty is leviable on the value of goods plus basic custom duty payable.
- (3) Additional Duty to compensate duty on inputs used by Indian manufacturers: This is levied under section 3(3) of the Customs Act.

Any import of textile in India such as raw wool is liable for levy of excise duty.

Annex 2: Treatment of Input Tax Credit on Capital Goods

One of the key objectives of GST is to simplify taxation of goods and services such that greater impetus is given to investment and consequently growth in the economy. Since capital goods form the major component of investment, simplification of taxation of capital goods is a key step towards achieving this objective. In India in most states credit is available to traders and manufacturers for tax paid on capital goods, to the extent it has been used for the manufacture of taxable goods.

Time Period for availing Input tax Credit on Capital Goods in respect of VAT

Since the tax paid on capital goods is generally greater than the tax liability of the manufacturer in a particular month, the Input Tax Credit (ITC) can be claimed over an extended period. The white paper on State-Level Value Added Tax by the Empowered Committee of State Finance Ministers in 2005 recommended a maximum period of 36 months during which input tax credit on capital goods can be availed though states may, and consequently a few have, at their option, reduced this number.

In *Uttar Pradesh*, according to the amendment of Rule 24 of UPVAT Rules, input tax credit can be claimed in three equal and successive annual instalments starting from the assessment year subsequent to the one in which the capital good has been purchased.

In *West Bengal*, on the other hand, if the value of capital goods purchased is less than Rs. 1 crore, the entire input tax credit has to be claimed in the same month as the month of capitalisation of the asset. If the value of the asset exceeds Rs. 1 crore, then the ITC can be staggered over four half yearly instalments starting from the month in which such capital goods were capitalised in the books of account of the dealer. On the other hand, the state of *Maharashtra* gives full input tax credit in the month of purchases only. However, if the capital asset is sold within a period of 36 months, proportionate credit is withdrawn.

In *Odisha* too, the input tax credit on capital goods can be adjusted against the output tax over a period not exceeding three years. When the value of capital goods involved is less than or equal to rupees one lakh, credit on the entire input tax paid is allowed in lump sum. Such credit is allowed from the date of first sale of taxable goods produced or manufactured after the commencement of such production.

Similar to *Uttar Pradesh*, in *Bihar* ITC can be claimed over a period not exceeding 36 months from the date of the acquisition of capital goods. In a month only a thirty-sixth part of the tax paid on capital goods can be claimed as input tax credit. In case the claim for input tax credit against capital goods for any month exceeds the output tax for the same month, such excess is allowed to be carried forward for adjustment against the output tax of subsequent months, not being a month later than two years after the close of the year during which such excess had arisen. The amount of input tax remaining unadjusted after two years after the close of the year during which such excess had arisen is to be refunded to the dealer.

A reverse credit is done where the input tax credit availed is more than the amount admissible according to the respective VAT Act. In *West Bengal*, where the capital goods are disposed of otherwise than by way of sale within a period of three years from the date of purchase, the input tax credit enjoyed by the dealer on the purchase of such capital goods is reversed.

Restrictions on Input Tax Credit on Negative List of Goods

In the White Paper on State-Level VAT, the empowered committee states that a negative list of capital goods would be prepared on which ITC is not to be allowed. However the states, it seems, have modified this list according to their preferences. Some states have explicitly created a separate list of such capital goods in schedules to their VAT Act while a few others have mentioned them as part of their VAT Rules.

In Odisha, for example, Schedule 'D' of the Odisha Vat Act lists the capital goods or their specific use on which ITC is not allowed. These include capital goods purchased prior to registration under VAT, or used in manufacture of goods or provision of services or trading activities not liable to tax under VAT, capital goods used in energy/power including captive power.

Similarly the Bihar VAT Rules disqualify taxes paid on purchase of goods such as civil structure and immovable goods or properties, vehicles of all types, office equipment and furniture and fixtures from being used for input tax credit as long as such goods have been used as capital goods.

Restrictions on Input Tax Credit on Capital Goods partly used in Manufacture of Taxable Goods

ITC on capital goods is allowed in most states where capital goods are required, for the purpose of manufacture or resale of taxable goods or for execution of works contract, as the case may be. If the goods purchased are used partially for the purposes specified, the input tax credit is allowed to the extent they are used for the purposes specified.

Treatment of Input Tax Credit on Capital Goods in Cenvat

The credit on Cenvat paid for capital goods purchased can be taken only for an amount not exceeding 50% of the duty paid on capital goods in the same financial year in which capital goods are received. The balance can be availed in the subsequent financial years. However, where the goods have been cleared as such, that is, without being used for the purpose of any production, the input tax paid can be credited in the same financial year as the purchase of the good. Input tax paid on capital goods purchased by Small Scale Manufacturers can also be credited entirely in the same year as the year of purchase of the capital good.

Annex 3: Calculation of the Share of Organised Sector

The estimation of the gross value added (GVA) of the organised sector for each of the 130 categories of the I-O Matrix was done using data from three sources:

- ▶ 2007-08 Commodity x Commodity Input-output matrix
- ▶ Statement 76.1 of National Account Statistics 2013
- ▶ NSS 67th Round - Survey on Unincorporated Non-agricultural Enterprises (Excluding Construction) in India

Statement 76.1 gives the NAS estimates of the gross value added of 17 sectors (including sub-sector) of economic activities, separately for the organised and the unorganised part each. The organised sector consists of companies that are registered under the Companies Act. Estimation of GVA of all the sectors in the I-O matrix in 2011-12 was done separately for the organised and unorganised part. The share of organised sector was calculated as a proportion of the sum of the two parts.

The share of the organised sector in each of the I-O matrix categories was estimated by first mapping the entire 130 categories of the I-O matrix onto the 17 categories of NAS. The relative share of GVA of each I-O matrix category within its respectively mapped NAS category was calculated. These shares were multiplied by the gross value added (GVA) by the organised sector in 2011-12 as given by NAS to get the organised sector value added.

In a similar manner, the same ratios of GVA were used to calculate the share of unorganised sectors for all the I-O Matrix Categories. For the manufacturing sector, however, data from the 67th Round Survey by National Sample Survey Organisation (NSSO) was used to calculate the shares of the unorganised sectors. Data on the gross value added per enterprise and the number of enterprises was obtained for the unorganised parts of 25 manufacturing sectors. By multiplying these two sets of data the GVA of each of these sectors was determined. The two sectors related to textile were 'manufacture of textiles' and 'manufacture of wearing apparel'. These 25 sectors were further aggregated into 22 sectors which could be conveniently mapped to the manufacturing sectors in the I-O Matrix. The relative shares of these were multiplied with the Gross Value Added of unorganised manufacturing obtained from NAS 2011-12. Thus the GVA (according to NAS) of the unorganised manufacturing was estimated for each of these 22 sectors. Next, the 68 manufacturing categories in I-O Matrix were mapped to these 22 manufacturing sectors. Subsequently, the share of GVA by organised manufacturing for all these 68 categories was also collapsed into the 22 aggregated categories. The total GVA was calculated by adding the organised and unorganised sector GVA for each of these sectors. The share of organised sector GVA was estimated as a share of total GVA 2011-12 for these sectors and consequently mapped onto the 68 manufacturing categories in the I-O Matrix.

Annex 4: Calculation of Central and State Tax Rates

To estimate the revenue neutral rate of GST for the textile sector the various taxes paid by the sector in 2011-12 had to be estimated and reduced from the final consumption expenditure. These taxes include the following:

- ▶ Central taxes: Excise Duty paid including various cesses and additional duties, and service tax after taking into account various abatements.
- ▶ State taxes: Value-added tax, Entry tax paid

The 2007-08 Input-Output matrix was used as the basis for calculation of the tax burden in 2011-12. The sectors which served inputs into the textile sector were identified. The effective burden of the above mentioned taxes was calculated on all these sectors besides calculating the output tax burden borne by the nine textile sectors themselves.

To calculate the tax burden, the tax rates applicable on the various inputs and outputs of the textile sector had to be ascertained first. Central tax rates would be common across states. However, state tax rates vary from state to state.

Five states with share in the national consumption totalling to about 47.4% were chosen as a sample. These states were Andhra Pradesh, Bihar, Maharashtra, Uttar Pradesh and West Bengal.

Each input category covered several products and services. The rate for each type of tax for each such specific product/service was ascertained using which an average tax rate was calculated for the respective input-output category.

To ascertain the excise duty rates, each individual product/category was mapped onto relevant HSN code/s. The respective tariff was ascertained after taking into account various cesses, exemptions and additional duties. Cesses such as the education cess, the secondary and higher education cess and the clean energy cess were included. The effect of both general and textile specific exemptions besides additional duty of excise levied under miscellaneous acts was taken into account.

Similar to the determination of excise duty rates, the service tax rates were ascertained by first mapping the various input services onto the respective chapter headings of the Service Tax Act under which they would fall. Since rates applicable for 2011-12 were required, the positive list of services applicable during that period was used. The final rates were calculated after taking into account the effect of various abatements.

Similarly VAT and entry tax rates were determined taking into account any additional taxes.

Annex 5: Calculation of Total Final Use

To estimate the tax base of the textile sector, the following formula was used:

$$\begin{aligned} \text{Tax Base incl. of taxes} \\ &= \text{TFUSE of the textile sector} + \text{IIUSE of the textile sector} \\ &\quad - \text{Inputs sold from Unorganised sectors to the unorganised textile sector} \end{aligned}$$

$$\text{Tax Base excl. of taxes} = \text{Tax base incl of Taxes} - \text{Central taxes} - \text{State taxes}$$

The Total Final Consumption Expenditure for the 130 categories of I-O Matrix was estimated using the formula:

$$\text{TFUSE} = \text{PFCE} + \text{GFCE} + \text{GFCF} + \text{Change in Stocks} + \text{Exports} - \text{Imports}$$

Where,

TFUSE = Total Final Expenditure

PFCE = Private Final Consumption Expenditure

GFCE = Government Final Consumption Expenditure

GFCF = Gross Fixed Capital Formation

The value of each component of TFUSE was estimated for each sector within the Input-Output matrix, by distributing the total overall value as given by the National Accounts Statistics (NAS) amongst the Input-Output (I-O) matrix categories. Ratios for distribution of PFCE, GFCE, GFCF, Change in Stocks, exports and Imports were calculated using the respective figures given by the latest available Input-Output Commodity x Commodity Matrix 2007-08.

As a first step towards calculating PFCE, the 38 categories of PFCE given by NAS were mapped onto the 93 categories of I-O Matrix in which Private final consumption was shown as having taken place. The relative share of each I-O Matrix category within the overall NAS category was calculated. The PFCE figures released by NAS for 2011-12 at current prices were brought down to 2007-08 prices using a linking factor calculated as follows:

Linking Factor

$$\begin{aligned} &= \frac{(\text{PFCE at Current Prices in 2011} - 12) / (\text{PFCE at Constant Prices in 2011} - 12)}{(\text{PFCE at Current Prices in 2007} - 08) / (\text{PFCE at Constant Prices in 2007} - 08)} \end{aligned}$$

The linking factor was calculated for each category of NAS separately so as to capture the individual category movement of prices separately. Later, the reciprocal of the linking factor was used to bring the prices back to 2011-12 levels.

The private final consumption figures so estimated were distributed amongst the respective categories of I-O Matrix using the relative shares of each category of I-O Matrix. These figures were subsequently brought upto to 2011-12 prices. Thus the PFCE of each of the 130 categories of the I-O matrix was estimated.

The share of GFCE, GFCF, Change in Stocks, Exports and Imports of each commodity in the I-O Matrix 2007-08 was used to distribute the 2011-12 value of the respective component of final demand as given by NAS.

In this manner the total final demand for each of the 130 commodities in the economy as categorised by the I-O Matrix was calculated.

Annex 6: Details of Duty Drawback Schemes

Brand Rate of Duty Drawback

The exporter has to make an application to the Commissioner having jurisdiction over the manufacturing unit, within 3 months from the date of the 'Let Export' order. The application should include details of materials/components/input services used in the manufacture of goods and the duties/taxes paid on such materials/components/input services. The period of 3 months can be extended up to 12 months subject to conditions and payment of requisite fee as provided in the Drawback Rules, 1995.

In terms of Rule 6 of the Drawback Rules, 1995 on receipt of the Brand Rate application, the jurisdictional Commissioner shall verify the details furnished by the exporter and determine the amount/rate of Drawback. Where exporter desires that he may be granted Drawback provisionally, the jurisdictional Commissioner may determine the same, provided the exporter executes a general bond, binding himself to refund the Drawback amount granted to him, if it is found later that the Duty Drawback was either not admissible to him or a lower amount was payable. The Brand Rate letter is thereafter issued to the exporter. The Custom House of the port of export is also given a copy to facilitate payment of Drawback to the exporter.

Supplementary claims of Duty Drawback:

Where any exporter finds that the amount of Duty Drawback paid to him is less than what he is entitled to on the basis of the amount or rate of Drawback determined by the Central Government, he may prefer a supplementary claim. This claim has to be filed within 3 months of the relevant date, which is fixed, as follows:

- (i) Where the rate of Duty Drawback is determined or revised under Rules 3 or 4 of the Drawback Rules, 1995 from the date of publication of such rate in the Official Gazette;
- (ii) Where the rate of Duty Drawback is determined or revised upward under Rules 6 or 7 of the Drawback Rules, 1995, from the date of communicating the said rate to the person concerned; and
- (iii) In all other cases, from the date of payment or settlement of the original Duty Drawback claim by the proper officer:

The period of 3 months can be extended up to 18 months subject to conditions and payment of requisite fee as provided in the Drawback Rules, 1995.

Procedure for claiming Duty Drawback:

The Duty Drawback on export goods (whether AIR or Brand Rate) is to be claimed at the time of export and requisite particulars filled in the prescribed format of Shipping Bill/Bill of Export under Drawback. In case of exports under electronic Shipping Bill, the Shipping Bill itself is treated as the claim for Drawback. In case of manual export, triplicate copy of the Shipping Bill is treated as claim for Drawback. The claim is to be accompanied by certain documents as laid down in the Drawback Rules 1995. If the requisite documents are not furnished or there is any deficiency, the claim may be returned for furnishing requisite information/documents. The export shipment, however, will not be stopped for this reason.

Limitations on admissibility of Duty Drawback:

The Customs Act, 1962 lays down certain limitations and conditions for grant of Duty Drawback. No Duty Drawback shall be admissible where:

1. The Duty Drawback amount is less than Rs.50/-.
2. The Duty Drawback amount exceeds one third of the market price of the export product
3. The Duty Drawback amount is less than 1% of FOB value of export (except where the amount of Duty Drawback per shipment exceeds Rs.500/-).
4. Where value of export goods is less than the value of imported material used in their manufacture. If necessary, certain minimum value addition over the value of imported materials can also be prescribed by the Government.

In case there is a likelihood of export goods being smuggled back, the Government can impose certain conditions which need to be fulfilled before the Duty Drawback is granted. Notifications have been issued under Section 76 of the Customs Act, 1962.

The prior repatriation of export proceeds is not a pre-requisite for grant of Duty Drawback. However, the law prescribes that if sale proceeds are not received within the period stipulated by the RBI, the Duty Drawback will be recovered as per procedure laid down in the Drawback Rules, 1995.

Annex 7: Salient Features of Duty Credit Scrips

1. Free Transferability

Duty Credit Scrip (Focus Product Scheme (FPS) including Market Linked Focus Product Scheme (MLFPS), Focus Market Scheme (FMS) and Vishesh Krishi and Gram Udyog Yojana (VKGUY)) and items imported against it are freely transferable. Status Holder Incentive Scrip shall not be transferable except as permitted under specific conditions.

2. Imports Allowed/Domestic Procurement

Duty Credit Scrip may be used for import of inputs or goods including capital goods, provided same is freely importable and/or restricted under ITC (HS). However, import of items listed in Appendix 37B of HBPv1 are not permitted to be debited. Duty Credit Scrip under Chapter 3 of FTP can be utilized for payment of duty against imports under EPCG (Export Promotion Capital Goods) scheme provided the item is importable against the Scrip. It can also be utilised for payment of Excise Duty on domestic procurement of such items as permitted to be imported under respective scheme.

3. Utilisation of Duty Credit Scrips

Additional customs duty/excise duty paid in cash or through debit under Duty Credit Scrip can be adjusted as CENVAT Credit or Duty Drawback as per Department of Revenue rules, except under SFIS. Utilization of Duty Credit Scrip for imports from a port other than port of registration is allowed under Telegraphic Release Advice (TRA) facility as per Department of Revenue notification

Procedure for Using the Scrips

The salient features of the procedure for using the credit scrips for adjustment against Cenvat and customs duty is as follows:

- a) The scrip should be registered with the Customs authority at the port of registration
- b) The holder of the scrip, who may either be the person to whom the scrip was originally issued or a transferee-holder, should present the said scrip to the said Customs authority along with a letter or proforma invoice from the supplier or manufacturer indicating details of its jurisdictional Central Excise Officer and the description, quantity, value of the goods to be cleared and the duties leviable thereon.
- c) The Customs authority, taking into account the debits already made towards imports, shall debit the duties leviable, but for this exemption in or on the reverse of the said scrip and also mention the necessary details thereon, updates its own records and sends written advice of these actions to the Central excise Officer;
- d) At the time of clearance, the holder of the scrip should present the said scrip debited by the said Customs authority to the Central Excise Officer along with an undertaking addressed to the said Officer that in case of any amount short debited in the said scrip he shall pay on demand an amount equal to the short debit, along with applicable interest;
- e) Based on the said written advice and undertaking, the said Officer should endorse the clearance particulars and validate, on the reverse of the said scrip, the details of the duties leviable, but for this exemption, which were debited by the said Customs authority, and keeps a record of such clearances;

f) The manufacturer should retain a copy of the said scrip, debited by the said Customs authority and endorsed by the Central Excise Officer and duly attested by the holder of the scrip, in support of the clearance under this notification.

On 18th April, 2013 the Annual Supplement to the FTP expanded the scope of the utilisation of the duty credit scrips to include payment of service tax on procurement of services within the legal framework of service tax exemption notifications under the Finance Act, 1994. The holder of the scrip is entitled to avail drawback or CENVAT credit of the service tax debited in the scrips as per Department of Revenue rules.

All duty credit scrips issued under Chapter 3 of the FTP can also be utilized for payment of application fee to DGFT for obtaining any authorization under Foreign Trade Policy. This benefit is available only to the original duty credit scrip holders. Duty credit scrip can also be paid for payment of composition fee and for payment of value shortfalls in EO under para 4.28 (b) of Hand Book of Procedure Vol. 1.

4. Exclusivity of Entitlement

Only one benefit under Chapter 3 schemes can be claimed by an exporter for a particular shipment. The various schemes include FPS, FMS, SFIS, Status Holder Incentive Scheme and VKGUY.

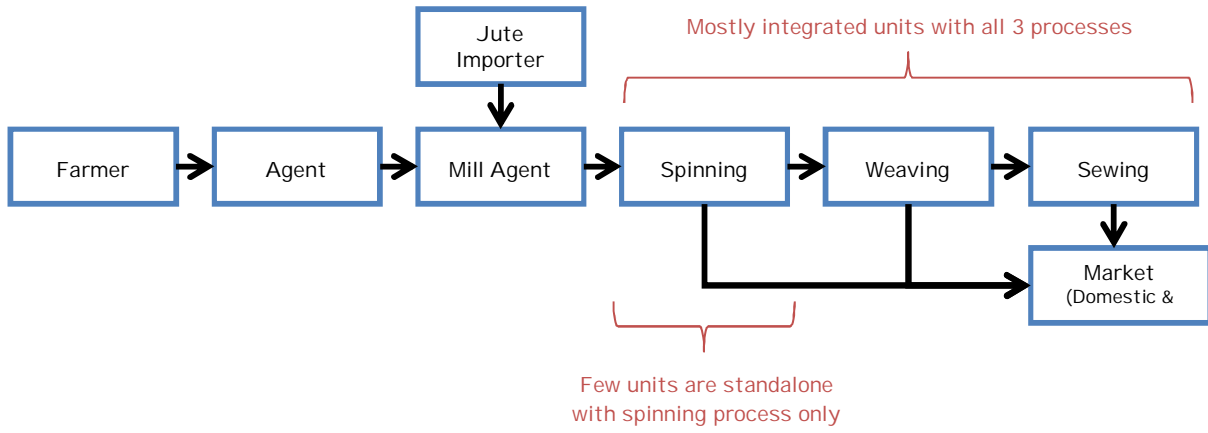
5. Import under Lease financing

Duty Credit Scrip can be utilised for payment of duty in case of import of capital goods under lease financing in terms of provision in Para 2.25 of FTP.

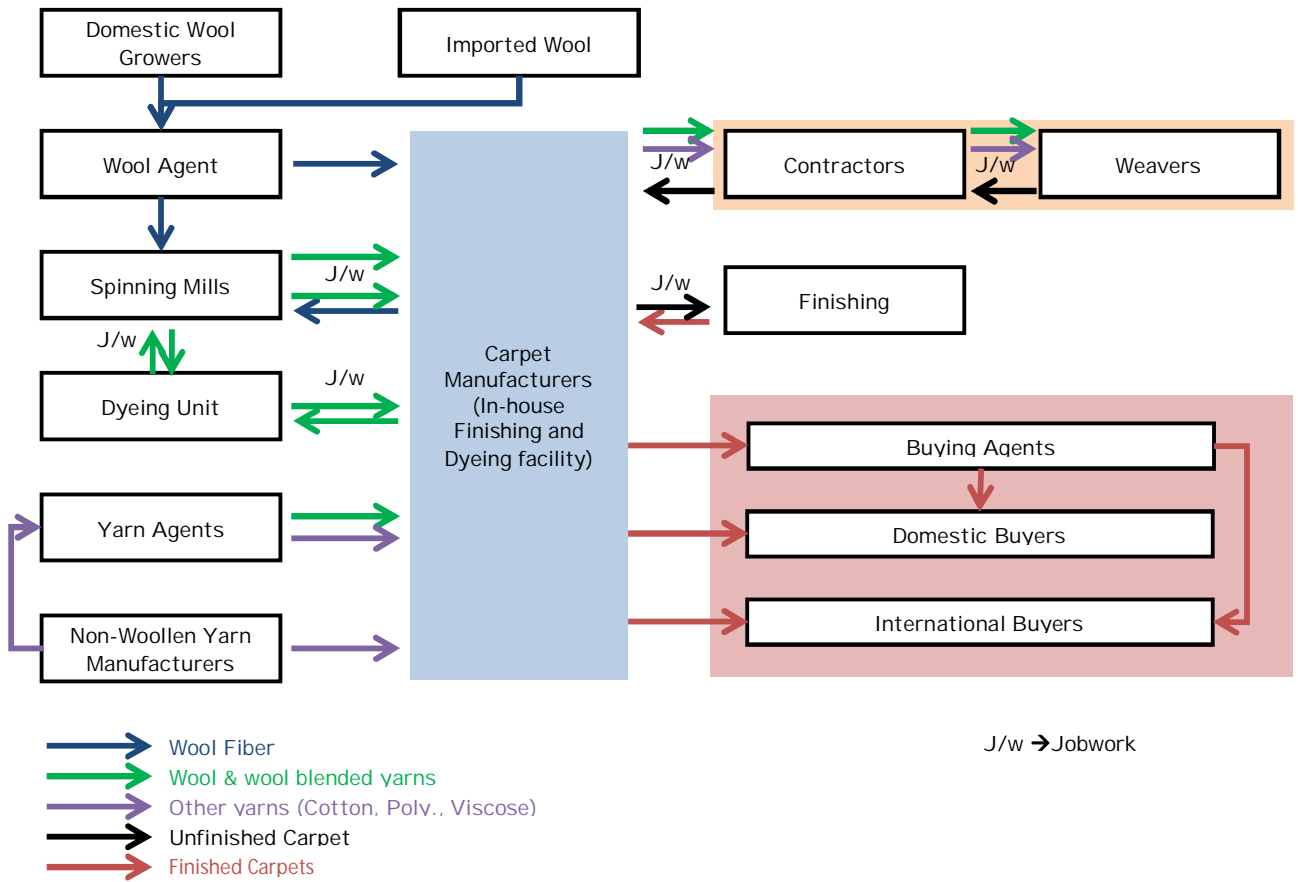
6. Transfer of Export Performance

Transfer of export performance from one to firm to another is not permitted. However, for VKGUY, FMS and FPS (including MLFPS), benefits can be claimed either by the supporting manufacturer (along with disclaimer from the company /firm who has realized the foreign exchange directly from overseas) or by the company / firm who has realized the foreign exchange directly from overseas.

Annex 8: Jute Sector Value-Chain



Annex 9: Carpet Weaving Sector Value Chain



Annex 10: Changes in Cenvat and State Tax Rates

This study constitutes an analysis of the impact of GST on the textile sector with respect to the tax rates prevalent in 2011-12. 2011-12 is latest year for which data, comprehensive enough to conduct the study, was available. As a result, the revenue neutral rates (RNR) calculated for the sectors are applicable to the year 2011-12. Given the RNR of 9.3% in 2011-12, the price elasticity and income elasticity of demand for textiles, the net impact of GST on the demand for textiles sector as a whole would be zero if the sector is taxed at 12% under the GST regime. As explained in the chapter on 'Estimation of Revenue Neutral Rates', the impact of GST would definitely vary across different textile subsectors but the overall demand for the sector would not be negatively impacted.

However, the revenue neutral rates are a function of all the central and state taxes, either directly applicable on the textile sector output, or indirectly on the inputs used by it since the sector also suffers from the problem of blocked input taxes. The central and state tax rates underwent significant changes in the last five years.

Changes in Central Tax Rates

Major overall change in tax rates:

- ▶ Standard rate of excise duty for non-petroleum goods reduced from 14% to 8% in a phased manner from 2008-09 to provide fiscal stimulus post the global financial crisis
- ▶ Service tax rate reduced to 10% in February 2009
- ▶ Excise duty rate raised to 10% in Budget 2010-11
- ▶ Excise duty rate and service tax rate increased to 12% in budget 2012-13 and as per the Tariff Notification No. 18/2012 published on 17th March, 2012
 - ▶ Standard rate of excise duty and service tax was raised from 10 per cent to 12 per cent
 - ▶ Merit rate increased from 5 per cent to 6 per cent
 - ▶ Lower merit rate increased from 1 per cent to 2 per cent
 - ▶ Since education cess is continued to be levied at 3%, the effective standard excise duty rate increased from 10.3% to 12.36%

Major changes in tax rates specific to textile inputs/outputs:

- ▶ Excise duty on fabrics made from cotton alone increased from 5% to 6%
- ▶ Excise duty on synthetic textile inputs such as polyester and viscose also increased to 12%
- ▶ Abatement applicable to branded ready-made garments increased from 55% to 70% of the Retail Sale Price. Therefore, the net incidence of excise duty as a percentage of the Retail Sale Price of branded garments came down from 4.5% in 2011-12 to 3.6% in 2012-13

Impact

Price of several non-textile inputs including plastic products, machinery, chemicals and services such as transport services is thus expected to have increased.

Consequently, the increase in price of raw materials is expected to have been passed on to the price of textile goods.

State VAT Changes

Over the last five years, State VAT rates have been gradually revised upwards in different states. Most inputs into the textile industry other than petroleum products, natural gas and leather products are taxable at the lower rate. Data pertaining to VAT rates across the 17 general category states was collated and studied. Table 10.1 gives the progression of the lower and higher VAT rates across states.

- ▶ 2009-10: two states increased their lower rate while four increased their standard rate
- ▶ 2010-11: the lower rates were revised in five states while the standard rate was revised in three states
- ▶ 2011-12: six states revised their lower rates and five their standard rates
- ▶ 2012-13: three states revised their lower and standard rates - Karnataka, Kerala and Odisha
- ▶ Amongst the major textile consuming states (AP, Bihar, Maharashtra, Uttar Pradesh and West Bengal) the lower rate of VAT was revised upwards in:
 - ▶ In 2011-12 in the states of Andhra Pradesh and Bihar
 - ▶ In 2010-11 in Maharashtra
- ▶ In Bihar, VAT on diesel was reduced to 16% from 18% in 2012-13

Overall Impact

Thus the overall tax burden on the textile sector is expected to have increased in 2012-13 with the attendant consequences on price and demand. According to rough estimates, as compared to domestic consumption demand for textiles in 2012-13, the effects of price and income elasticity for textiles would get evened out at a GST rate of 14%.

Table 10.1: Lower and Higher VAT Rates Across Selected States: 2007-08 to 2012-13

#	State	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
1	Andhra Pradesh	4%, 12.5%	4%, 12.5%	4%, 14.5% (15 Jan 2010)	4%, 14.5%	5%, 14.5% (14 Sep 2011)	5%, 14.5%
2	Assam	4%, 12.5%	4%, 12.5%	5%, 13.5% (31 Oct 2009)	5%, 13.5%	5%, 13.5%	5%, 13.5%
3	Bihar	4%, 12.5%	4%, 12.5%	4%, 12.5%	4%, 12.5%	5%, 13.5% (1 Apr 2011)	5%, 13.5%
4	Chhattisgarh	4%, 12.5%	4%, 12.5%	5%, 14% (1 Jan 2010)	5%, 14%	5%, 14%	5%, 14%
5	Gujarat	4%, 12.5%	5%, 15% (incl. addl tax, 1 Apr 2008)	5%, 15%	5%, 15%	5%, 15%	5%, 15%
6	Haryana	4.2%, 13.13%	4.2%, 13.13%	5.25%, 13.13% (15 Feb 2010)	5.25%, 13.13%	5.25%, 13.13%	5.25%, 13.13%
7	Jharkhand	4%, 12.5%	4%, 12.5%	4%, 12.5%	4%, 12.5%	5%, 14% (7 May 2011)	5%, 14%
8	Karnataka	4%, 12.5%	4%, 12.5%	4%, 12.5%	4%, 12.5%	5%, 14% (1 Apr 2011)	5.5%, 14.5% (1 Apr 2012)
9	Kerala	4%, 12.5%	4%, 12.5%	4%, 12.5%	4%, 12.5%	4%, 12.5%	5%, 13.5% (1 Apr 2012)
10	Madhya Pradesh	4%, 12.5%	4%, 12.5%	5%, 12.5% (1 Aug 2009)	5%, 13% (1 Apr 2010)	5%, 13%	5%, 13%
11	Maharashtra	4%, 12.5%	4%, 12.5%	4%, 12.5%	5%, 12.5% (1 Apr 2010)	5%, 12.5%	5%, 12.5%
12	Odisha	4%, 12.5%	4%, 12.5%	4%, 12.5%	4%, 12.5%	4%, 13.5% (1 Apr 2011)	5%, 13.5% (1 Apr 2012)
13	Punjab	4%, 12.5%	4%, 12.5%	5%, 12.5% (29 Jan 2010)	5.5%, 13.75% (1 Apr 2010)	5.5%, 13.75%	5.5%, 14.3% (3 Sep 2012)
14	Rajasthan	4%, 12.5%	4%, 12.5%	4%, 14% (8 Jul 2009)	4%, 14%	5%, 14% (1 Apr 2011)	5%, 14%
15	Tamil Nadu	4%, 12.5%	4%, 12.5%	4%, 12.5%	4%, 12.5%	5%, 14.5% (12 Jul 2011)	5%, 14.5%
16	Uttar Pradesh	4%, 12.5% (1 Jan 2008)	4%, 12.5%	4%, 12.5%	4%, 12.5%	4%, 12.5%	4%, 12.5%
17	West Bengal	4%, 12.5%	4%, 12.5%	4%, 12.5%	4%, 13.5% (15 Nov 2010)	4%, 13.5%	4%, 13.5%

Annex 11: Constituents of Textile Segments in Input-Output Matrix

I-O Category number	Category Name	Category Constituents
46	Khadi, cotton textiles in handlooms	Cotton spinning in charkha, khadi weaving and finishing of cotton textiles in handlooms
47	Cotton textiles	Cotton ginning, cleaning and baling, spinning, weaving and finishing of cotton textiles in mills and power looms, printing, dyeing and bleaching of cotton textiles, cotton textiles n.e.c
48	Woolen textiles	Wool cleaning, baling and pressing, wool spinning, weaving etc. (handloom, powerlooms and mills), dyeing, bleaching and manufacture of woollen blankets, shawls, felts and others
49	Silk textiles	Spinning, weaving, finishing, printing, dyeing and bleaching of silk textiles
50	Art silk, synthetic fibre textiles	Spinning, weaving and finishing of synthetic fibres, rayons, nylons etc. Printing, dyeing and bleaching of synthetic textiles, other silk and synthetic fibre textiles
51	Jute, hemp, mesta textiles	Pressing, baling, spinning and weaving, finishing of jute, mesta, hemp and other coarse fibre, dyeing, printing and bleaching of jute textiles, manufacture of jute bags and other jute textiles
52	Carpet weaving	Weaving carpets, rugs, durries and others
53	Ready made garments and made up textile goods	Readymade garments, clothing and tailoring, made up textile goods, curtains, bed covers, furnishings, mosquito nets
54	Miscellaneous textile products	Cotton, woollen and synthetic fibres knitting in mills or otherwise, thread and thread ball making, jute, cotton, hemp, sisal, nylon rope, cordage and twines, nets, webbing, narrow fabrics, embroidery work, laces, fringes, zari and zari products, manufacture of rain coats, hats, umbrellas etc., Oil cloth, rubberised cloth, tarpaulin, artificial leather, made-up canvas goods, coir fibre, yarn and coir products, linoleum and similar products, gas mantles and other textiles viz. Bandage, gauze, dressing cloth

Annex 12: Terms of Reference

1. Mapping the entire textile value chain including handicrafts and carpets in the country with current exemptions and rates of customs duties, excise duties, VAT and other indirect taxes including service tax on goods and services in all states/UTs.
2. To identify the problems faced by various sectors of the textile industry in the current taxation regime like discontinuation of the textile value chain resulting in denial of input duty relief, CENVAT accumulation, disparity etc.
3. Analyse the need and justification to exempt any sub-sector or item in the textile industry
4. Implications (both positive and negative) of GST on vulnerable segments of textiles like handlooms, block printing, screen printing, tie & dye and other hand processing units.
5. Recommendations regarding Revenue Neutral Rates (RNRs) of GST (both central GST and state GST) for all the identified segments of textile sector and implications and likely impact of such rates on these segments
6. Recommendations regarding basis of exemptions and threshold limits for exemptions under GST after consultation with all the relevant stakeholders in the sector
7. Preparations/measures required for textiles industry to adjust to proposed new tax structure