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Impact of VAT Implementation on Price Stability and Economic Welfare of Jammu & Kashmir: An Empirical Study on Tax Authorities' Perception

Mohammad Ashraf Malla
Associate Professor, Department of Commerce and Management Studies,
Government College for Women, Nawakadal, Srinagar, Jammu & Kashmir, India

Abstract:
Stability in prices and economic prosperity are the two important pillars of general welfare and wellbeing of the people. The other development objectives are also based on these two features of the economy. Stability in prices and growth in revenue are the positive economic effects of an indirect tax system like Value Added Tax (VAT) system. An indirect tax system should have no inflationary effects on prices. It should be income elastic and growth oriented. The present paper is an attempt to examine as to how far value added tax system has been effective to stablise the prices and contribute to the economic welfare of J&K from the perspective of State Tax authorities (Tax administrators). The paper also suggests some measures to make VAT more income and growth oriented in the State.

Keywords: Value added tax, price stability, economic welfare, tax authorities, infrencial statistics, parametric test cascading effect, Jammu & Kashmir

1. Introduction

In order to ensure a sizeable improvement in the general welfare of the society, stability in prices and economic prosperity are the two necessary conditions. These also act as the basis for other development objectives. Economic effects of indirect taxes such as stability in prices and growth in revenue are of great importance (Chelliah Committee, 1991). The principal objective of a tax is to raise sufficient revenue. An indirect tax system should also have a least impact on the pattern of consumption. It should not be inflationary (Adam, 1910). It should be growth oriented. The indirect tax system should not only maintain stability in prices but should also bring the prices down. In an economy the fiscal authorities expect that the tax system in practice should have no adverse effects on prices rather should offer maximum relief to those upon whom its axe falls (Malla, 2013). Value added tax system being the innovation of 21st century has become a favourite feature for the tax authorities and economists across the world in view of its attractive socio – economic benefits. A consumer is benefitted under VAT by paying less for a commodity as there is no tax on tax and also his consumption pattern is not disturbed. Traders gain because of the provision of input–tax–credit. The Government benefits because of the tax systems' capacity to garner more revenue and leaving a little scope for tax evasion.

How far VAT in Jammu & Kashmir has been effective to ensure stability in prices and contribute towards economic welfare of the State? The present paper is an attempt to measure the success of VAT on these two fronts from the perspective of State Tax Administrators. The paper also suggests the outlines for future course of action needed to make the system more economy friendly.

2. Review of Literature

Different countries have adopted VAT in varying degrees. A brief review of some studies is presented as under:

Ministry of Finance, Govt. of Korea (1980) suggests that the introduction of VAT did not have any marked unstable impact on prices in Korea. Brookingls' Institute (1981) in its study on impact of Value Added Tax on prices, suggests that a reduction in VAT by 1% would reduce prices by 0.7%. The overall experience suggests that VAT is not inflationary (Tax Council, 1983)

Commenting on the revenue realizing potential of VAT, Cnossen (1997) is of the view that a properly designed VAT raises more revenue with less administrative and economic costs than any other broadly based taxes. Sanjive (2004) in his study views that VAT would enhance the competitive strength of domestic trade and industry, push up the economic reform process and achieve unification of State Level Sales Tax. Mustafa (2005) in one of his studies concluded that on the whole as per the experience of many European and Asia – Pacific Countries, the benefits of VAT outweigh its disadvantages. VAT would be superior to sales tax system in terms of allocative efficiency, neutrality and other economic effects (Purohit, 1993).

Purohit (1995) in another study views that in addition to achieving economic efficiency and avoiding cascading effect of tax levied at earlier stages, the State VAT would enable the States to raise larger revenues. Godbole (1998), recommended the introduction of VAT as a substitute for Sales Tax in Jammu and Kashmir in order to garner more revenues for the budgetary support of the State.

Vat does not have any adverse effects on savings as it can be efficiently used to curb the consumption of luxuries as well as socially undesirable goods (Purohit, 2001). Archana (2005) opines that with the introduction of VAT, the overall tax burden will be rationalized and prices in general will fall, tax base will widen, compliance will be better and above all the revenue will increase.

Most of the studies on different dimensions of VAT have concluded that besides bringing stability in prices it has capacity to garner more revenue for the federal Governments.

3. Objectives of the Study

The study has been conducted with the following objectives in mind:

1. To examine the perception of State Tax Authorities viz. a. viz. the impact of VAT implementation on the Price Stability and economic welfare of the State.
2. To suggest the outlines for future course of action in respect of administration of VAT in the State in order to make it socially and economically viable.

3.1. Hypothesis

Null Hypothesis (H_0): The perception of tax authorities of the sample cities (Srinagar and Jammu) regarding the impact of VAT on price stability and economic welfare is the same.

Alternative Hypothesis (H_1): The perception of tax authorities of the sample cities (Srinagar and Jammu) regarding the impact of VAT on price stability and economic welfare differs significantly.

4. Materials and Methodology

4.1. Sample

Samples for the study have been drawn from two representative cities of the state viz Srinagar and Jammu (both are capital cities). Questionnaire Method was used to collect the information from the respondents (Srinagar = 50 and Jammu = 61) with two demographic features viz, Designation and length of service.

4.2. Instrument Used

To assess the perception of respondents about the subject of enquiry, a questionnaire based on five variables (statements) was prepared and administered.

The variables were:
- Effect on prices
- Effect on purchasing power of consumers.
- Effects on growth in registration of traders for tax payment.
- Effect on revenue generation, and
- Effect on cost of administration of VAT.

05 point Likert Type Scale (as shown in Table I below) was used to quantify the data. There were five boxes with number – 1 for strongly disagree, 2 for disagree, 3 for neither agree not disagree, 4 for agree and 5 for strongly agree, against which the respondents were requested to mark their responses for the statements.

Strongly Disagree	Disagree	Neither Agree nor Disagree	Agree	Strongly Agree
1	2	3	4	5

Table 1: 05 Point Likert Scale

4.3. Data Collection Process and the tools used

The data collected was assessed for its reliability co – efficient. Here Cronbach Alpha (1951) was used. The minimum Alpha Value 0.50 (Nunally, 1967) was taken as the test value. The present study showed a reliability co – efficient = 0.72

For the purpose of Statistical analysis, besides descriptive statistics comprising Average, Standard Deviation, (S.D) Co – efficient of variation (C.V) and Rank Correlation (R1 & R2) a Parametric Test namely, Z test to examine the significance of difference of means, was also conducted to help in arriving at the logical conclusion.

4.4. Analysis of Data

A two-way model was used for data analysis:
01. Individual sample basis, and
02. Joint sample basis.

Analysis on these two bases facilitated a comparison of the perception of tax authorities of two sample cities regarding the problem of research under study. The variable wise analysis of the subject is presented in Table 2 below:

Variables		Srinagar		Jammu		Overall		Srinagar	Jammu
		Mean	S. D	Mean	S. D	Mean	S. D	C.V	C.V
01.	Effect on prices	3.74	.80	3.38	.95	3.56	.90	21.47%	28.16%
02.	Effect on purchasing power of consumers	3.26	1.08	3.18	1.12	3.22	1.10	33.25%	35.15%
03.	Effect on growth in registration of traders	4.34	.87	4.38	.55	4.36	.71	20.09%	12.62%
04.	Effect on revenue	4.04	.86	4.10	.87	4.07	.86	21.18%	21.12%
05.	Effect on cost of administration of VAT	3.65	1.05	3.49	1.01	3.57	1.03	28.82%	28.93%
		3.81	1.01	3.71	1.03	3.76	1.02	26.45%	27.68%

Table 2: Price Stability and Economic Welfare (Tax Authorities Perception)
Source: Personal survey of sample cities

The overall mean score 4.36 indicates that there has been a considerable increase in the registration of traders after the implementation of VAT in the State. The following reasons could be responsible for this increase:

1. Increased surveillance of authorities, and
2. Strict adherence to various clauses of VAT Act, 2005.

It is undoubtedly true that the more the number of traders registered, the more the tax revenue and hence economic prosperity.

The overall mean score 4.07 shows that after the implementation of VAT in the State, there was no any decrease in tax revenue as was generally expected. Instead the revenue has increased considerably. The growth in revenue can be attributed to increase in the registration of new dealers – around 20% in VAT States (Padma Vathi, 2006) and around 109% in Jammu and Kashmir (Malla, 2013) after the implementation of VAT. This finding is in consonance with the finding of Federation of Indian Chamber of Commerce and Industry, (2006) according to which contrary to the initial apprehensions, the revenue inflow to the VAT implemented States, is high.

The mean scores 3.56 and 3.57 signify that VAT is non–inflationary and also economical in operation. This finding justifies two important canons of a sound Tax System viz "Neutrality" and "Economy". The positive implications of VAT include lower prices for consumers, lower costs of administration and protection of consumer's interests (Bahir, 2006).

On the whole, the analysis shows that tax authorities are reasonably satisfied with the working of VAT in the State. The data further signifies that on independent sample basis, the perception of respondents about the problem under study in view of mean scores 3.81 and 3.71 with the corresponding co – efficient of variation 26.45% and 27.68% respectively is almost the same. However, the Kashmir based tax officials seem to have a better perception as compared to their Jammu counter–parts at least about the three variables viz, "effect on prices", "effect on purchasing power of consumers" and effect on cost of administration in view of the mean scores assigned to these variables by them.

The reasons could be:

- Kashmir based tax officials (Like Kashmiri Consumers) are more price conscious.
- Harsh attitude of Kashmir based Tax Officials towards registered dealers which acts as an obstacle in charging more prices from the consumers.
- There has been no improvement in physical infrastructure of Kashmir wing of the Commercial Taxation Department which is a clear indication that there has been no any significant increase in the cost of administration of VAT.
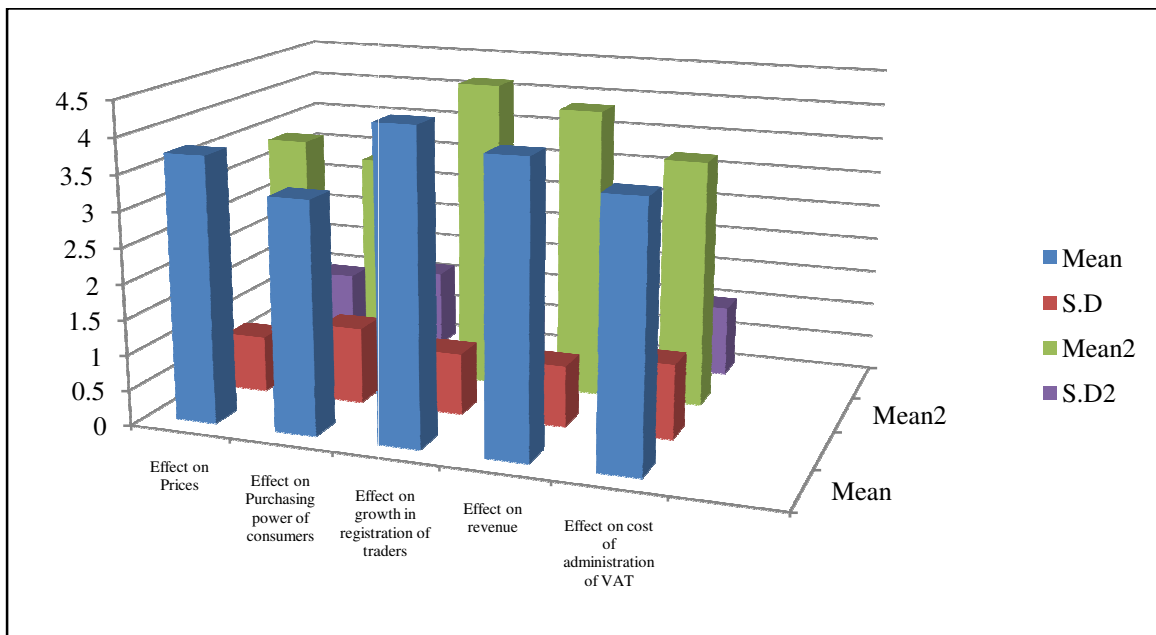

Figure 1: Descriptive Analysis

In order to notice the perceptual gap as regards the subject, the data was tested for rank analysis also. The results are presented in Table 3, below:

	Variables	Srinagar		Jammu	
		Mean	R1	Mean	R2
01.	Effect on prices	3.74	3	3.38	4
02.	Effect on purchasing power of consumers	3.26	5	3.18	5
03.	Effect on growth in registration of traders	4.34	1	4.36	1
04.	Effect on revenue generation	4.04	2	4.07	2
05.	Effect on cost of administration	3.65	4	3.49	3

Table 3: Ranks allotted
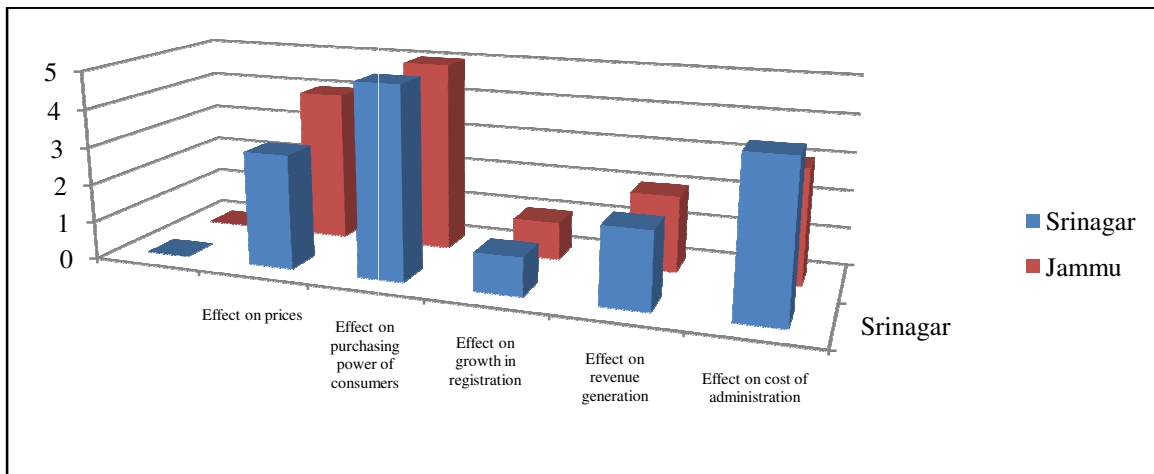*Source: Researcher's personal survey of sample cities*

Figure 2: Relational Analysis

The variable wise allotment of ranks by the respondents of the two samples show that in respect of 3 variables out of 5, the respondents, have a similar perception. However, there is a slight perceptual gap with regard to effect on prices and effect on cost of administration which is almost negligible.

4.5. Analysis for Inferences
As a part of inferential analysis, a parametric statistical test namely "Z Test" was performed on the data to facilitate a comparison in the perception of tax authorities of the two sample cities about the subject and thus draw inferences about the laid hypothesis. The results are presented in Table–4 below:

Dimension	Srinagar		Jammu			
	Mean	S. D	Mean	S. D	Z	P
Price stability and economic welfare	3.81	1.01	3.71	1.03	0.52	0.60

Table 4: Z Test

The test shows that the calculated value 0.52 with P value 0.60 at 1% level is statistically insignificant implying that Null Hypothesis (H_0) is accepted as against the Alternative Hypothesis (H_1). This indicates that there is complete uniformity in the perception of administrators/ Tax authorities of two sample cities about the price stability and economic welfare dimension of Jammu and Kashmir State VAT.

5. Conclusion and Suggestions
The proceeding discussion has led to the conclusion that VAT is a very apt tax for the State as compared to the erstwhile sales tax system as it is more revenue oriented and guarantees a reasonable level of stability in the prices of goods. This has become possible due to the following reasons:
- Increase in the number of traders for registration under VAT.
- Close monitoring and surveillance of tax authorities to check attempts of tax evasion, by resorting to secret deals and under valuation of goods by the traders.
- Provision of harsh clauses for non–compliance and nonpayment of otherwise due taxes.
- Provision of input – tax credit.
- Lower tax rate structure.

- Compulsory audit assessment.

Further, in order to make it more attractive, effective, efficient and apt, the administration has to be more sincere and transparent and there has to be a better compliance. Sincerity in administration and compliance demands the co – operation and co – ordination among all the stake holders.

To ensure a continued growth in revenue, tax evasion has to be arrested at all costs. For this purpose, computerization of all Tax Processing and Collection Units including Check Posts have to be ensured. The administration needs to ensure proper invoicing, constitution of mobile inspection teams and price checking squads, awarding incentives to honest tax payers, fixing of targets in registration for the smooth and result oriented administration of VAT in the State.

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