

Joint Press Briefing Notes by

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Introduction

Mr. Minister, distinguished guests, ladies and gentlemen,

I am very happy and honoured to be here today representing the OECD at this conference to celebrate and publicise India's considerable achievements over the last 5 years.

My fellow Vice President Ms Shaefer-Preuss has produced an excellent overview of where Indian stands on its economic reforms. I will limit myself to giving an OECD perspective on these reforms.

India is enjoying a period of sustained economic growth and is increasingly embracing the principles of a market based economy. The OECD believes that tax systems play a key role in economic development. Developing countries need effective tax systems to provide the funds needed by governments to invest in the physical and social infrastructure required for development. At the same time, all countries are reviewing their tax systems to identify obstacles to both domestic and international investment and to improve compliance.

No matter how good tax policies may be, their effectiveness depends on the efficiency of the tax administration. I am therefore very encouraged by the emphasis India is placing on improved tax administration.

Economic Reforms

Over the past two decades, India has moved away from a state interventionist model to become a market-based economy. But as Vice President Ms Schaefer-Preuss emphasised this is an inclusive model of development. Direct tax rates have been significantly reduced, pervasive government licensing of industrial activity has almost been eliminated, and restrictions on investment by large companies have been eased.

At the same time, financial markets have been reformed. The Rupee now floats on the international exchange and foreign exchange controls have been relaxed. Banks have been restored to health, entry barriers lowered, equity markets transformed and new supervisory bodies introduced.

A progressive lowering of tariffs to an average of 10% in 2007 has encouraged foreign suppliers to enter the market. Rules governing foreign direct investment have been markedly eased, notably in the manufacturing sector.

The whole process of reform is characterised by an opening up of the economy, and an effort to ensure that the benefits of growth are fairly shared among different segments of the production.

Spectacular Improvement in economic performance

These reforms have had a major beneficial impact on the economy and in the growth of international trade. To take a few headline figures:

- By 2006, the average share of imports and exports in GDP had risen to 24%, up from 6% in 1985.
- Inflows of foreign direct investment increased to 2% of GDP from less than 0.1% of GDP in 1990 (US FDI has tripled since 2000 to \$8.5 billion)
- Outflows of foreign direct investment picked up substantially at the end of 2006, exceeding inflows, making India a net capital exporter.

- The service sector was a decisive and strong driver for growth. Internet use has increased by a factor of ten since 2000.
- Faster growth has resulted in India becoming the third largest economy in the world (after the United States and China and just ahead of Japan) in 2006, when measured at purchasing power parities. Yet India still accounts for less than 2% of world trade,, which is the one third of China's role.

India's economic performance is impressive by any standards. As I indicated earlier one important driver of economic development, and the one we are to discuss this week, is the reform of the tax system.

Tax Reforms and economic growth

India's growth in international trade has been facilitated by an across the board reduction in rates of tax. Customs duties are down, corporation taxes are down (though still relatively high), and tariffs are down. Importantly, despite the reduction in tax rates revenues are up due to faster growth and thereby allowing the government to invest in the country's infrastructure.

The scope of tax reform efforts in India is well illustrated by the agenda for this weeks meeting, where we have 6 parallel sessions covering Direct and Indirect taxes and such issues as Strengthening Audit Capacity, Improving Taxpayer Service, Transfer Pricing and other International areas. A recurrent theme is the importance of improving the administration of taxes. And let me add that the OECD strongly supports the ADB efforts in this area.

A difficult domestic policy issue for India to resolve is the fate of the many incentives and exemptions in the tax system. These include Special Economic Zones, Export processing area and Software technology parks. The work undertaken by the OECD suggests that such schemes generate very little new investment and that there are considerable advantages in ending such incentives and exemptions. It is not always clear that they achieve their policy objectives. Also they have a tendency to distort the economy and they do not result in sustainable tax revenues. I recognize, however, that this it is a difficult issue for India.

On the international front, the growth in cross border transactions, in particular India's shift from capital importer to both a capital importer and exporter, and the increased importance of the service sector, brings new challenges for the tax system. If India is to continue its emergence as a major world economy it is important to develop a tax system that promotes inward and outward investment and the competitiveness of India based multinationals. At the same time, increased flows of goods, services and capital, and India's concern to tax an appropriate share of the profits arising from these cross border transactions, mean that India today has a much bigger stake in the development of broadly acceptable international tax rules. It is also in India's interest to ensure that disputes with both multinational enterprises and other tax administrations are resolved speedily and in a principled fashion.

I am optimistic that India will be ready for these future challenges. What is particularly encouraging about India's tax reform programme is that despite all the improvements that have been made India does not see the reform process as completed. Indeed one of India's stated objectives for this conference is to learn from experiences of other countries on how to take the reforms even further. India sees this conference not as the end of the process, but as a stepping stone to the next level.

In this context, one of the major challenges is to reconcile the need for a tax system which is simple, economically efficient and at the same time ensures that the costs and benefits of development are fairly shared.

On-going Policy Dialogue

The discussions at the meeting identified a number of areas for future work:

Tax Policy

There is a clear need to increase overall tax revenues and at the same time to raise the yield from direct tax. Equally, one of the major challenges for India is to get in place an integrated nation-wide VAT. The experience of the OECD can help in these respects.

Tax Administration

(a) Improved Taxpayer Service

We have a group working on this, which include South Africa and Malaysia, so we can draw upon their expertise.

(b) Better Risk Management

This will be a theme of the next Forum on Tax Administration, which will be held in South Africa next January. It can help India to have a more targeted risk management, to reduce the case load of inspectors, and to enhance the relationship between tax administration and taxpayers.

(c) Improved co-operation among customs, direct and indirect taxes in the area of valuations of related party transactions.

International Taxation

(a) Transfer Pricing

My reading is that the 2001 legislations seem broadly fine, but India perhaps could be more selective in which Multi-National Enterprises it audits, find ways of reducing the time it takes to close cases, and provide officials with more scope to negotiate settlements so that fewer cases end up in the courts. MNEs want more certainty and transparency. Advance Pricing Agreement may be an option to look at. You may also want to engage more with the OECD as we revise our 1995 Transfer Pricing Guidelines.

(b) Application of Tax Treaties

India's position on treaties is well known, and the emphasis placed on the source taxation; OECD respects this choice. But what we have heard over the last two days is that business is looking for greater consistency and transparency in the application of treaties and more effective dispute resolution mechanism. A good start would be to endorse the recently released 25 Best Practices in Mutual Agreement Procedures.

OECD Cooperation with India.

The OECD has recognised for some time that it is important to engage with India, one of the world's largest and fastest growing economies. In the tax area this engagement takes many forms.

- Experts from OECD countries have been participating in events in India's tax training centre in Nagpur since 2002.
- The OECD reviewed and commented on India's 2001 Transfer Pricing Legislation and has been working with ADB on capacity building in tax services.
- In 2006 India became an Observer to the Committee of Fiscal Affairs, enabling it to participate in all meetings of the CFA's working bodies.
- In May earlier this year the OECD identified India as a country with which the OECD wished to enhance its engagement with a view to possible membership of OECD.
- In June India and other major emerging economies (Brazil, China, Mexico and South Africa) met with G8 to discuss the challenges that have arisen in the world economy. The Summit recognized that neither grouping could address these challenges in isolation. In a Joint Statement India and the other countries committed to co-operate on promoting cross border investment, working together to promote more favourable conditions in their countries for investment. The Summit acknowledged the role of the OECD in facilitating policy dialogue and cooperation between G8 and the major emerging economies such as India.
- I see the Conference this week, which brings together India's tax officials with officials from OECD and Non-OECD economies, as part of the dynamic policy dialogue to strengthen our partnership with India. And I am optimistic that the opportunity this week to share country experiences on issues of common interest will help us achieve this goal.