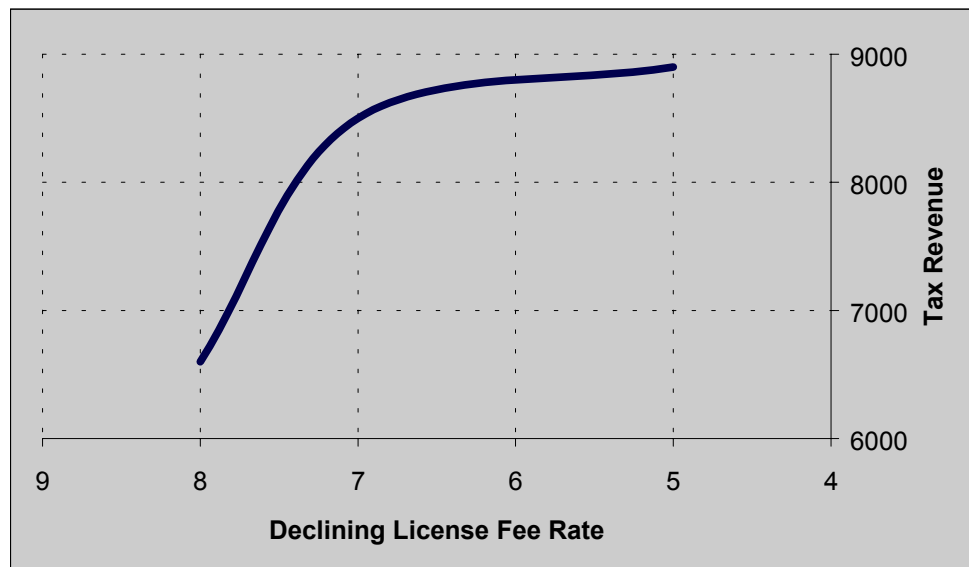


Impact of low taxation rates on total tax receipts of the government; establishing the Laffer Curve Relationship

- ❖ In November 1974 Arthur Laffer, a young economist, drew a curve on a napkin in a Washington bar, linking average rates to total tax revenue. Initially, higher tax rates would increase revenue, but at some point further increases in tax rates would cause revenue to fall, for instance by discouraging people from working.
- ❖ The curve became an icon of supply-side economics. Some economists said that it proved that most governments could raise more revenue by cutting tax rates, an argument that was often cited in the 1980s by the tax-cutting governments of Ronald Reagan and Margaret Thatcher.
- ❖ In the context of the Indian telecom sector, we have tried to establish how the government shall actually gain from lowering of levies / tax rates on the telecom sector.
- ❖ Lower levies on telecom sector will mean a much higher disposable surplus for reinvestment. Lower levies will reduce cost of service and thus enable widespread expansion of affordable services. Usage of service shall go up as a result of which the revenues of the telecom sector shall rise substantially.
- ❖ Higher telecom revenues will translate into higher tax revenues for the government. Besides there will be much greater direct and indirect benefits from the resultant economic growth.
- ❖ In the table below we have tried to establish how a reduction in licence fee to 5% will result in a higher growth in subscribers and also higher Average revenue per user (ARPU) because of affordability of service.
- ❖ In our projections we have captured only the licence fee and service tax revenue to the government from mobile service providers. We have tried to project the impact of lower licence fee levy on the absolute volume of tax receipts of the government from the mobile service providers.
- ❖ We have projected that as a result of a reduction in licence fee from the present weighted average of about 8% to 5% (scenario 2) the total revenue for the government from licence fee and service tax from mobile service providers will rise from an estimated amount Rs 6,600 crs in the current financial year to about Rs 8,800 crs in FY 2007 (scenario 2).

Particulars	Estimated FY 06	Projected FY 07	Projected FY 07
		<i>Scenario 1</i> 7% Licence fee levy	<i>Scenario 2</i> 5% Licence fee levy
Mobile Subscriber base	81	127	133
%age growth	55%	57%	65%
Monthly Average Revenue per User (ARPU)	380	375	372
Total Annual Revenue of Mobile services	36,754	56,944	59,367
Licence fee in %age	8%	7%	5%
Licence Fee	2,940	2,847	2,968
Service Tax @ 10%	3,675	5,694	5,937
Total Licence fee and Service Tax revenue to the govt (in Rs Crs)	6,616	8,542	8,905



- ❖ From the above it is evident that maximization of telecom sector revenues is in the best interest of the government as higher revenues will translate into a much higher tax receipts for the government.