

# GST – A PANACEA FOR ECONOMIC GROWTH IN INDIA?

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## Abstract

On 1 July 2017, the government made an ambitious shift to what it promised was a modern, transparent and technology-driven indirect tax system to sharpen the competitive edge of a \$2.3 trillion Indian economy driven by internal trade barriers and a raft of central, state and local taxes. GST subsumed 17 central, state and local taxes in line with the “one nation, one market, one tax” concept on which it was based. The goods and services tax (GST) was hailed as the biggest tax reform by India in 70 years of independence, a potential game-changer that would, at one stroke, unite the country of 1.3 billion people into a common market by dismantling inter-state tariff barriers. This paper discusses the apprehension relating to proposed GST regime regarding the growth in Indian Economy and its effects thereof. A more rational tax system would lead to lesser disruptions to the market economy and more efficient distribution of resources within industry. As we know in India economy, destination based taxation requires high compliance cost and efficient administration.

*Index Terms* – GST, tariff, game-changer

## I. Introduction

The introduction of GST is one of the landmark tax reforms in India’s post-independent history. GST is a destination tax for consumer states, and there are reasons to hope it would bring in more tax revenue. To make India as a financial super power, the introduction of GST is must. There are much apprehension relating to proposed GST regime regarding the growth in Indian Economy and its effects thereof. As we know in India economy, destination based taxation requires high compliance cost and efficient administration.

Taxation both direct and indirect plays an important role in promoting economic growth as well as equitable distribution. As we are facing the cascading system of indirect taxes in India and with the introduction of GST, all the cascading effects of Cenvat and service tax will be more comprehensively removed with a continuous chain set off from the producer’s point to the retailer’s point. Moreover, certain major Central and State taxes will also be subsumed in GST.

**Table no. 1 Central and State Taxes in the Pre-GST Period**

Central Taxes	State Taxes
Excise tax	Entry Tax
Service tax	VAT/CST Tax
Customs tax	Tax on Lottery
	Luxury Tax
	Advertisement Tax

We have also experienced the benefits from the Vat reform which include the growth in economics of States and business community.

The structure of GST will be based on the destination principle. As a result, the tax base will shift from production to consumption whereby imports will be liable to tax and exports will be relieved of the burden of the goods and service tax. International exports should be zero rated. On the other hand, International imports should be subject to both CGST and SGST at the time of importation irrespective of whether or not the imported goods are produced domestically. Moreover, GST will redistribute the burden of taxation equitably between manufacturing and services bringing about a qualitative change in the tax system. It will lower the tax rate by broadening the tax base and minimizing exemptions.

The greatest impact of the implementation of the GST would create a common market across the country and reduce compliance costs and thus, create a equitable distribution. In the absence of significant fiscal options, incentivized policy to attract investors to states would shift to greater emphasis on structural reforms. The over macroeconomic effect of reduction in economic distortions due to GST would be to provide an impetus to economic growth. Thirteenth Finance Commission estimates the impact of the introduction of a GST which would eliminate all taxes on production and distribution and rest on final consumption only. It is also expected that the opportunities of employment will be enhanced.

The implementation of a comprehensive GST will lead to efficient allocation of factors of production and will lead to gain in GDP and exports. It would enhance economic welfare and returns to the factors of production, i.e. land, labour and capital. The implementation of GST across goods and services is expected, to provide gains to India 's GDP somewhere within a range of 0.9 to 1.7 per cent. The corresponding change in absolute values of GDP over 2008-09 is expected to be between Rs. 42,789 crore and Rs. 83,899 crore, respectively. The manufacturing sectors would benefit from economies of scale. Output of sectors including textiles and readymade garments; minerals other than coal, petroleum, gas and iron ore; organic heavy chemicals; industrial machinery for food and textiles; beverages; and miscellaneous manufacturing is expected to increase. The sectors in which output is expected to decline include natural gas and crude

petroleum; iron ore; coal tar products; and nonferrous metal industries." Considering the share of service sector in the state GDP, the benefit of GST to the state is expected to be more enormous. Once the current issues in the GST system are resolved, the state is optimistic about a positive turnaround in its revenue growth and revenue-led fiscal consolidation can be restored sooner. Numerous rate changes, failure to ensure that benefits are passed on to consumers, absence of e-way bill, changes in the threshold and attempts to tinker with the architecture of GST have brought confusion and popular protest. The state government has little power to intervene in the situation. The GST's important fallout has been the erosion of state's taxation powers. The new regime had tax slabs for goods and services—5%, 12%, 18% and 28%.

## II. Literature Review

(Poonam, 2017) The biggest problems in Indian tax system like Cascading effect & tax evasion, distortion can be minimized by implementing GST. A single rate would help to maintain simplicity and transparency by treating all goods and services as equal without giving special treatment to some 'special' goods and/or services. The launch of GST would transform Asia's third largest economy into a single market for the first time.

(Shakdwipee, 2017) in his paper inquiring the level of awareness towards GST among the small business owners in Rajasthan state, found that the main areas to be focused include Training errors and Computer software availability.

(Mohamad Ali Roshidi Ahmad, 2016) in his seminal work regarding "Introducing the GST in Malaysia" stated that government should have careful planning, detailed preparation, participation of community and extensive public education program is the key success in the implementation of GST for any country.

(Nasir, 2015) reveals that tax morale is the most influence factors to tax awareness. This means government need intense focus on publics' knowledge and attitude towards the implementation of GST.

## III. Objectives of the Study

- To study the prospects of GST in India
- To evaluate the role of GST in the economic growth of India
- To explore the road map ahead for GST

## IV. Discussions and Findings

At the institutional level, GST in India is a bold experiment of pooling of sovereignty by the centre and the states in matters of taxation. This can have huge implications on the political economy of the nation as also on how our polity can be structured for functional purposes in the years to come. The GST Council has created a fraternity of finance ministers. At a professional level, the Council is a forum for sharing best practices. At a personal level, it has engendered a rarely seen camaraderie. Consequently, functioning of the

Council has risen above political party lines and ideologies. The party lines may not have been obliterated, but have certainly been blurred. Nothing can be more encouraging for economic policymaking in the country.

The first 100 days haven't caused as much of a disruption in the basic macro-economic variables as had been expected or as had been the cross-country experience. There hasn't been a post-GST inflation spiral as has been seen in many countries like Singapore, Australia and New Zealand. Despite many hassles and operational glitches in the information technology (IT) systems, the proportion of registration to returns is a healthy 60%. Also even though the states have got into a liquidity problem and are taking recourse to overdrafts, the revenue loss has not been such that it will cause a fiscal crisis.

In terms of policy framework, the big gain is that for the first time there are uniform rates for commodities across the country. True, there is still a long way to go before the one tax-one nation goal is achieved in letter and spirit. But there is no denying that one tax on one commodity is a reality. Coming from a regime of extreme dispersion of rates, not only across states but within commodity groups, this has been a big move forward. Everyone seems to have already forgotten the nightmarish rate structure, say of the footwear industry, which had more than 19 rates within a state. Given the fact that GST as a tax regime is still work-in-progress, the multiple rate slabs will converge overtime. It is very likely that the two slabs of 12% and 18% will converge to 14.5% sooner than later. Indeed, the Union finance minister indicated a reduction of tax slabs a couple of days ago. Along with this, the number of commodities attracting 28% tax will have to be trimmed.

It is true that the GST council erred on the side of caution and pitched the rates high. This was driven by revenue considerations as well as compensation financing requirements. It needs to be pointed out that the way the compensation scheme for loss of revenue due to GST is designed, states have virtually got a tax insurance! It effectively covers everything ranging from inefficiency in collection to loss caused by a natural calamity. Such an open-ended compensation could not have been financed by the centre's receipts alone. The move away from commodity-specific exemptions, which was the fountainhead of corruption and granting largesse, is also a giant step towards transparency. Without taking note of any of these systemic changes, an emerging public discourse is making GST out to be not only an unmitigated disaster but also the sole reason for the economic slowdown in the country. This is substantively erroneous and contextually misleading. The transitional troubles of businesses and adjustment anxieties of the overall macro-economic system are being portrayed as tardy implementation, procedural lapses and systemic failures of the new tax regime. One often hears that the issue of procedural and compliance matters has become very cumbersome in the new regime. While there is some merit in the argument, especially with regard to small businesses, let us not forget that three months ago businesses were filing multiple returns: separate returns for value-added

tax (VAT), excise duty, service tax, and countervailing duty. All these have been replaced by one GST return. What is causing compliance distress is not the returns per se but the frequency of filing; from a quarterly cycle, businesses have had to move to a monthly cycle.

It should be possible for the GST Council to address this issue based on the emerging revenue patterns. Depending on the size-class frequency distribution of businesses and their revenue contributions, the filing frequency can be calibrated and changed. Indeed, the finance minister recently hinted as much at one of his public functions when he revealed that 400,000 returns account for most of the revenue. It is, however, important to recognize that the compliance burden is not due to the obsessions of the tax bureaucracy. The compliance framework aids a major structural change: the formalization of the Indian economy. As such these are troubles of transition not to a new tax regime but to a new form of business organization. Most of the pains that are being faced by the small businesses, the informal, unorganized sector, are in part from the formalization of the Indian economy, which is being advanced by the compulsory filing of returns. Comparable, though not as glamorous as the liberalization of the 1990s, or globalization of the 2000s, the distinctive push towards formalization of the country's informal economy through GST is the biggest structural gain from implementation of this indirect tax reform. So it must at least be understood if not happily endured. In terms of the paper work, accounting, business processes, the serious constraints that have emerged and have the potential to cause liquidity stress in small businesses is the reverse charge mechanism.

It is being felt that the small businesses are bearing a disproportionate burden in accounting for transactions from the unregistered segment. While technically the reverse charge mechanism is required, the GST Council can help ease the small businesses into this system over time. Notwithstanding this, the widespread pangs of transition must be alleviated by relaxing the procedural norms. In small but meaningful ways, GST procedures must incentivize the transitions which will eventually result in growth in output and jobs as the economic units in the informal economy move and get relocated in the formal economy.

The formalization will lead informal workers out of poverty, powerlessness, exclusion and vulnerability. The formalization through GST can also mean that entrepreneurs in the informal segment can more easily access capital and credit, and invest it in their businesses to obtain higher productivity and sustainability.

### **Initial Period of Disruption for Businesses**

Predictably, GST has set off an initial period of disruption for the businesses. Small and medium enterprises have encountered difficulties with the new tax. Gaps in GST returns filings remain, and the government has been deferring the filing deadlines. Partly, this is a result of glitches in the IT portal and the high compliance requirements set out in the law. Even though the idea behind the invoices matching system to input tax

credits is sound, as it helps tackle tax evasion and frauds, it has proven to be a big hurdle to cross every month for many less-tech savvy Indian businesses. Based on the practical problems of businesses, the GST Council and the government have been proactively taking remedial actions. For example, the GST Council on 6th October approved many measures to reduce the compliance burden on small and medium enterprises. Additional measures are expected in the November 10 meeting. Even so, given the required smoothening of the information technology system, policy changes and need for businesses to get familiar with the new system, the process of stabilisation may take up to a year from the launch.

### **GST Will Lead to Higher Growth in Medium Term**

What will be the GST's impact in a longer time frame? The initial euphoria of GST has been replaced in some quarters by doubts on whether it will stimulate growth in the way as was believed. Critics have been arguing that Indian GST is more complex than GST in other countries because of multiple rate slabs and granular assignment of goods and services to them. Even if not perfect, GST does embed many fundamental reforms elements that are important in raising economic efficiency. For example, by unifying the tax systems in different states, GST has dismantled barriers to inter-state trading, and thus helped in creating a national unified market. This will free up businesses to expand, and become more efficient. Similarly, many cascading taxes have been eliminated that used to distort firms decisions regarding input use. This will result in better cost efficiency and competitiveness even if the current GST rates have been kept high to cover for government's revenue loss.

### **Growth Impact**

Going by the experience of other countries that adopted GST, some economists had predicted that the tax reform would boost India's economic growth rate by up to two percentage points in due course as it eliminates inefficiencies in the tax system. Under GST, tax is levied only on the amount of value added at each stage in the supply chain. Businesses get a rebate for the taxes paid on raw materials and services used, which will make them more competitive as it eliminates "tax on tax". However, the production slowdown in the run-up to the implementation of the tax reform in July has had an adverse impact on supplies. "The disruption caused by implementation of GST was confined to the informal sector of the economy and it has largely bottomed out in July. Its effect will now taper off". ADB, which follows a calendar year, on 27 September revised its 2017 growth forecast for India to 7% from its July estimate of 7.4%, reflecting "short-term disruptions" such as last year's demonetization and the GST rollout that it expected to "dissipate".

## The Road Ahead

The challenge for the government will be to address the immediate issues being faced by the businesses, without diluting the prospects of medium-term economic growth from GST. There may be a temptation to reduce GST rates for small businesses to provide immediate relief. However, the design of such cuts should be made with sufficient caution. Unless they are part of a plan to rationalise the overall structure, there is a risk of further complicating the rate classification of goods and services, exacerbating the real issue of high compliance requirements. Creating a differentiated rate structure across small and large businesses shall end up distorting the incentives for small businesses to increase their scale of operation, which is clearly not desirable. Finally, to provide rate cuts while protecting revenues, the government may end up restricting the seamless flow of input tax credit, which may prove counterproductive.

Two areas on which the government could work on are as follows:

- The government could simplify the classification of goods and services to different rate slabs such that functionally similar items fall into a single tax slab. This will avoid confusion and ease compliance.
- The invoice-matching system also needs to be re-examined and potential alternatives should be explored. This could include retaining invoice-matching only for high-risk transactions, and using data-analytics to unearth cases of mismatch in returns of suppliers and buyers.

Close co-operation and communication between the government and business community will help navigate the immediate challenges in GST implementation. Over time, growth opportunities will emerge, especially in manufacturing and exports. There is no doubt that GST will be a catalyst towards transformational change in the Indian economy. The new system is yet to settle down. While many of the lofty and intangible goals set by the government will take time to achieve, the transition has witnessed inevitable shocks. Businesses slowed production ahead of the rollout of GST to minimize tax complications while shifting to the new system. This in part led to economic growth in the April-June quarter decelerating to 5.7%, the slowest pace in three years, from 6.1% in the preceding three months. Businesses and traders also struggled to measure up in the first two monthly tax-filing cycles, making headlines about inadequate preparedness for the massive tax reform.

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