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Editorial
GST in India needs reforms backed by research

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Implemented on 1st July 2017, Goods and Services Tax (GST), is the most pathbreaking indirect tax reform in independent India. Although India had the latecomer advantage, as she was preceded by about 160 countries, an India-specific GST paradigm has evolved considering our specificities. The destination-based consumption tax subsumed several pre-existing taxes the Union and state governments levied. The new simplified tax regime is designed to improve tax effort (tax-GDP ratio), end tax cascading, enhance efficiency and competitiveness, reduce prices, and accelerate GDP growth. The states have surrendered more taxing powers than the Centre, thus raising concerns about the fiscal autonomy of states. Hence, they were guaranteed the GST compensation that assured 14 percent growth in their GST revenue for the initial five years. As the new tax regime is about to complete seven years, it is pertinent to explore where the system stands concerning promises and the plausible way forward.

Revenue performance

There were concerns regarding poor revenue performance in the initial years of GST implementation. However, the performance has been impressive following the economic recovery after the COVID-19 pandemic, as the revenue collections touched new highs month on month during the previous fiscal year, 2023-24. The gross GST revenue in April 2024 reached ?2.1 lakh crore, scaling the new heights since its implementation. The average monthly collections in 2023-24 stood at ?1.68 lakh crore with a growth rate of 11.6%.

However, a comparative analysis of GST revenue performance between the pre-and post-GST period reveals that an increase in the tax base is still awaited. The average of total taxes subsumed under GST during 2012-17 was 6.13 percent of GDP. During 2017-2023 the GST-GDP ratio, excluding GST compensation cess, declined to 5.65 percent, whereas the ratio barely maintained the previous level of 6.13 percent if GST compensation cess (0.48 percent of GDP) is included.

States, in general, performed poorly during the post-GST period compared to the earlier period. In 16 out of 17 major states, the share of GST in GSDP showed a decline in the post-GST period, Jharkhand being the only exception. Further, 15 out of 17 major states showed a decline in the contribution of GST in their own tax revenue collection. The only exceptions here are Maharashtra and Tamil Nadu. Given the slip between the cup and the lip, it is pertinent to reflect on the underlying factors and the future agenda for reform.

Behind the slip

The observed performance could be seen in light of a host of factors, including the plethora of rates that presumably stood in the way of increased compliance in tax collection, inter-alia, on account of the proliferation of fraudulent claims for input tax credit. The GST rates in India which is shown to be much lower than many comparable countries which is divided between the Union and the states although the latter made more sacrifices. Another issue pertains to the issue of breaking open the black box of IGST which should be an issue of concern for the Union and the GST council. It was expected that being a destination-based tax, consumer states would be the beneficiaries. However, evidence from a consumer state like Kerala reveals that the ratio of IGST to SGST is only at a low level of 1.2, indicating a significant loss of revenue for the state.

The contours of reform

GST in India is still evolving and needs reform to ensure that the social marginal product of the reform is positive. From the perspective of States, there is much to be gained from redesigning the division of GST revenue between the Union and the States' wherein the share of States is raised from the present level of 50 percent. The functioning of the IGST clearing mechanism, despite the significant improvement over time, leaves much to be done.

In the reform agenda, the most discussed issue has been the simplification of rate structure. Arvind Subramanian, the former Chief Economic Advisor made the case for a three-rate structure with a standard rate of 18 percent, a lower rate of 10 percent, and a demerit rate of

40 percent. Since the GST compensation period is over, cesses should be incorporated into the normal rate structure at the top rate of 40 percent. This is expected to eliminate a major distortion whereby a significant source of revenues has been walled off from the standard divisible pool of taxes that provides resources for both the Centre and the states. Vijay Kelkar, the Chief Architect of India's GST and Chairman 13 Finance Commission, argued for a single GST rate based on the experience of most of the developed countries. Of the countries that follow GST, 80 percent, including Singapore, New Zealand, the United Arab Emirates, and Japan, have opted for a single tax rate and were successful in increasing compliance and minimizing tax disputes.

The need for reform in tax rates cannot be overemphasised. However, considering the country's abysmally low effort, one needs to ensure that the reforms do not cause further erosion in the tax effort. The rate structure change also needs to ensure that it does not aggravate the already rising levels of consumption inequality and fuel inflation, as it hurts the poor the most. There is a need for caution while replanting reforms from countries that have already achieved higher tax efforts with homogenous socio-economic structures. Reforms addressing the above issues call for more research backed by sound theory and empirics. Unfortunately, however, research on GST in the country is majorly handicapped by access to the needed data generated in plenty but yet to be made public.

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