The Impact Assessment of GST 2.0 on the Indian Economy

(A discriptive Analysis of GST 2.0 in Context of Indian Economy)

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Abstract

The introduction of the Goods and Services Tax (GST) in 2017 represented one of India's most ambitious reforms to indirect tax. However, criticisms relating to the complexities of compliance, the multiplicity of tax slabs, and frictions related to transitional arrangements accumulated. As a result, policymakers have pushed ahead with what is often referred to as incipient "GST 2.0." The purpose of this paper is to discuss some of the elements of GST 2.0, especially the rationalization of rates into two major tax slabs. By using a combination of theoretical analysis, policy reports and current media coverage, this paper assesses the implications for, amongst others, prices, demand, inflation, and government revenues in the short term, and makes observations about the implications for equality (both positive and negative) across states, sectors and firms. Although rationalization may yield some operational benefits in the long- term relating to simplification, support for lower dispute, and compliance levels, there are still some transitional operational challenges including: wage levels and volatility in tax revenues in the short-term period, and perhaps a greater difficulty adjusting to the increased compliance burden of SMEs in the long-run.

Keywords: GST 2.0, India, tax reform, fiscal policy, compliance, e-invoicing, indirect taxation

1. Introduction

India introduced Goods and Services Tax (GST) in July 2017, which was the culmination of over a decade of central and state government negotiations. GST sought to establish a common national market, minimize cascading effects, and enhance the efficiency of tax collection.

Companies grappled with multiple slabs of taxes (0%, 5%, 12%, 18%, 28%), too-frequent rate changes, complex regulatory compliance, and an overstrained GST Network (GSTN) portal from time to time. The states complained of the lack of revenue predictability, while small businessmen complained of the technical intricacies of monthly return filing and invoice reconciliation.

To this, policymakers launched an informal second wave of reforms referred to as "GST 2.0." This package of reforms is meant to streamline, stabilize, and make GST more modern. Transition to a leaner GST structure with fewer slabs (largely 5% and 18%) is intended to decrease compliance cost and enhance tax neutrality between goods and services, and simplify pricing and categorization for firms and tax administrations. To enhance enforcement and logistics monitoring, the introduction of E-Way Bill 2.0 with greater interstate integration holds the potential for enhanced freight monitoring, less transit bottlenecks, and more accurate data exchange between states, facilitating quicker risk-based actions and eased passage of goods through the supply chain. Combined, these actions aim to facilitate taxation, promote greater transparency, and enhance operational efficacy for taxpayers and regulators alike.

1.1 Evolution from GST to GST 2.0

GST 2017 unified excise duty, service tax, VAT and several cesses into a destination-based value-added tax, with multiple rate slabs that reflected political compromise rather than economic logic and placed the GST Council at the centre of federal tax decision-making.

GST 2.0 aims to address those shortcomings by simplifying the rate structure to reduce classification disputes and collapse slabs, while preserving revenue neutrality through a broader tax base; accelerating digitization to leverage automation for real-time compliance monitoring; and improving the ease of doing business—particularly for MSMEs—by lowering compliance burdens and increasing transparency across the tax system.

2. Research objective

1. Examine the Impact Assessment of GST 2.0 on Consumers Financial Behaviour
2. Examine the impact of GST 2.0 on Govt revenue
3. Study impact of GST 2.0 on different sectors of economy

3. Literature Review

- International evidence on VAT reforms suggests three consistent patterns:
- Simplification Improves Compliance: Countries like New Zealand and Singapore demonstrate that fewer rates reduce disputes and enhance compliance.
- Automation Reduces Evasion: Latin American countries adopting e-invoicing saw significant reductions in tax leakage.
- Short-Run Fiscal Risks: Rate rationalization often produces transitional revenue gaps until compliance gains materialize.
- Indian literature (Rao, 2019; Mukherjee, 2020; Kelkar Committee, 2022) echoes these points, while emphasizing federal bargaining challenges in GST Council decision-making.

4. Components of GST 2.0

4.1 Rate Rationalization

GST 2017 collapsed excise duty, service tax, VAT, and various cesses into a destination-based value-added tax, that had multiple rate slabs that were politically decided, not economically, with the GST Council at the center of federal tax decision–making.

GST 2.0 sets out to clean up those issues, by simplifying the rate structure, to minimize classification disputes and collapsing slabs, to maintain revenue neutrality through a broader tax base; improve digitization to accelerate and automate compliance, to allow for real-time monitoring; and improve ease of doing business—specifically for MSMEs—by reducing compliance, and increasing transparency across the tax system.

Category	Rate in GST 1.0	Rate in GST 2.0	Example Goods/Services
Essential items	0%	0%	Fresh food, unbranded cereals
Merit/low-rate goods	5%	5%	Textiles, footwear, small cars
Standard rate	12% & 18%	18%	Electronics, appliances
Luxury/sin goods	28% + cess	28% + cess	SUVs, tobacco, aerated drinks

4.2 New Reforms at Glance

What gets cheaper at 5%:

- Daily-use items: Hair oil, soaps, shampoos, toothpaste, toothbrushes, tableware.
- Food: Butter, ghee, paneer, UHT milk (0%), namkeen, bhujia, pasta, noodles, chocolates, coffee.
- Healthcare: Thermometers (18% → 5%), medical oxygen (12% → 5%), diagnostic kits, glucometers, corrective spectacles.
- Farm: Tractors (12% → 5%), tractor tyres (18% → 5%), drip irrigation, sprinklers, bio-pesticides.
- Education: Notebooks, maps, globes, pencils, crayons (12% → 0%), erasers (5% → 0%).

What moves to 18% (from 28%):

1. Automobiles: Small cars (≤1200 cc petrol, ≤1500 cc diesel), motorcycles (≤350 cc), three-wheelers, buses, and trucks.
2. Parts: Uniform 18% on all auto components.
3. Electronics: ACs, TVs (>32 inches), monitors, dishwashers, projectors.

The 40% Slab under GST 2.0

- Tobacco & Paan Masala – gutka, cigarettes, cigars, cheroots, cigarillos, and similar substitutes.
- Sugary Drinks – carbonated and caffeinated beverages.
- Luxury Cars & Bikes – >1200 cc petrol, >1500 cc diesel, and bikes above 350 cc.
- Yachts, Private Aircraft, and Helicopters.
- Online Gambling & Gaming Services – GST applies irrespective of legal restrictions.

4.3 Key Compliance & Technology Reforms under GST 2.0

Expansion of E-invoicing Threshold

- Earlier, e-invoicing was applicable only to large businesses above a certain turnover (e.g., ₹10 crore).
- Under GST 2.0, the threshold will be **expanded to include smaller businesses**, ensuring wider coverage and better invoice authenticity.
- This will help reduce fake invoicing, enhance tax compliance, and create a standardized documentation system across businesses.

Introduction of Invoice Management System (IMS)

- A new **IMS will enable real-time, seamless matching of input tax credit (ITC)** between buyers and sellers.

- It will minimize reconciliation errors, reduce fraud, and cut down disputes related to ITC claims.
- By integrating IMS with e-invoicing, the GST ecosystem will move toward **greater transparency and automation**.

Portal Upgrades to Reduce Downtime

- Frequent portal glitches and downtime have been a major concern for taxpayers.
- GST 2.0 will bring in robust IT infrastructure upgrades to handle peak filing loads smoothly.
- Features like faster load times, intuitive dashboards, and mobile-friendly compliance tools will improve the ease of doing business.

5. Research Methodology

A multi-method research design could be used to assess the consequences of GST 2.0. The impact on sales, prices, and tax compliance can be estimated using a Difference-in-Differences (DiD) approach comparing product categories whose tax rates changed with product categories where no tax rate change occurred which should provide us a causal attribution on the extent of the rate rationalization on product sales, changes in price and increases in tax compliance. A Synthetic Control Analysis could be conducted to see the aggregate revenue consequences of GST 2.0 as compared to a constructed counterfactual from the pre-reform trends at a broader fiscal level. At a microeconomic level, GSTN registered firm-level datasets and e-invoicing datasets can provide an insightful analytical window to observe compliance behaviour, allowing for studies of implications of reforms like the broader e-invoicing threshold and the Invoice Management system on reporting and payment of taxes. Household surveys may provide insights on distributional consequences of the increase in prices and changes in prices incurred by the GST on households across many income categories, in terms of consumer welfare and equity. Overall, these methods provide complementary evidence to assess GST 2.0 at the market, state, firm, and household level.

6. Research Observations

6.1 Prices and Consumption

GST 2.0 could also entail price reductions in key industries like textiles, electronics, and other sectors like hospitality, and this stems from tax rate rationalization and a reduction in the cost of compliance. Lower prices would improve affordability and stimulate demand, especially in price-responsive categories. Simply put: lower prices would get consumers in the mood to spend, especially with the Christmas festive period approaching and when consumers typically spend the most on clothing, electronic gadgets and hospitality. The best outcomes will occur for consumers when relatively lower effective prices are combined with increased demand. The knock-on effect will potentially improve consumption, an opportunity to support small businesses, jobs, and some distributors in the services sector.

6.2 Inflation

The harmonization of tax slabs under GST 2.0 is likely to have a mildly moderating impact on headline inflation, as lower indirect taxes on widely consumed goods will convert into lower retail prices. The direct effect may be little, considering most essential items are exempt, while higher rate taxes still apply to luxury goods. However, the reduction in rates across a range of industries, particularly textiles, electronics, and hospitality, may relieve some core inflationary pressures, which in turn may help consumers, especially in urban markets where spending on discretionary items is more acute to price changes. However, the impact of GST will depend on how efficiently businesses pass on the reduced taxes to consumers and whether some of the larger price benefits are eroded by seasonal demand.

6.3 Revenue Implications to Govt.

States could face temporary revenue shortfalls under GST 2.0, particularly as the merging of slabs (e.g., 12% and 18% merging into a flat 18%) and specific targeted rate reductions on textiles, electronics and hospitality can negatively impact revenue collection from those sectors immediately. The expectation is that while short-term collections could fall, over the longer term as compliance improves and demand increases the total tax base will also increase. However, states particularly reliant on these select categories may be under fiscal stress in the transition. This underscores the need for the centre to offer compensation, either through direct transfers, adjustments in revenue shares or temporary transfers, to provide much-needed coherency in public finances and preserve the idea of cooperative federalism. Important to provide some funding to states to maintain level of development spending, given only on GST 2.0 is taken into consideration for revenue gains.

6.4 Expected Short-Run Impacts of GST 2.0

Dimension	Expected Effect	Mechanism
Consumer prices	Falls	Rate cuts passed through to retail
Demand	Increases	Lower prices → higher consumption
Inflation	Fall	CPI basket items affected
State revenues	Fall (short-run)	Rate rationalization
Compliance costs	Rises (short-run)	System upgrades, e-invoicing burden

6.5. Long-Run Implications of GST 2.0

Efficiency Gains

- Simplified rate structure and stronger IT-backed compliance (e-invoicing, IMS) will reduce classification disputes and litigation.
- Businesses benefit from lower compliance uncertainty and smoother credit flows.

Revenue Neutrality

- Although short-run collections may dip, improved compliance, expansion of the tax base, and higher consumption are expected to restore and stabilize revenues in the medium to long term.

Equity

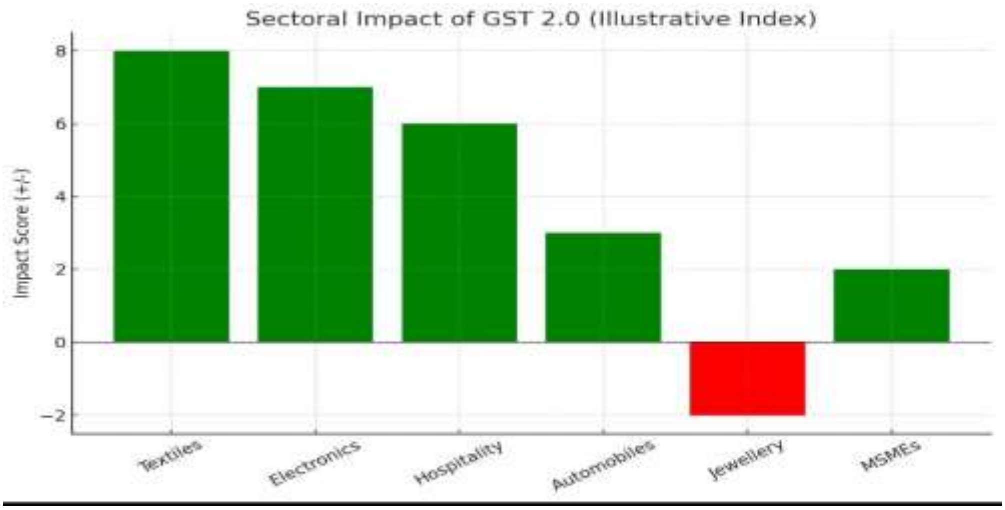
- Lower-income households stand to benefit proportionately more from reduced GST rates on essentials and mass-consumption goods.
- This enhances the **progressivity of indirect taxation**, complementing direct tax policies.

Federal Stability

- Sustaining cooperative federalism requires transparent and time-bound **compensation mechanisms** for states.
- A credible commitment from the Centre will prevent dissatisfaction and ensure smoother fiscal transitions.

6.6 Sectoral Winners and Losers

Sector	Likely Impact	Rationale
Textiles	Positive	Lower rates, high price sensitivity
Electronics	Positive	Rate cuts, strong festive-season demand
Hospitality/Food	Positive	Cheaper services attract middle-class consumers
Automobiles	Mixed	Small cars benefit; SUVs remain in high-slab
Jewellery	Negative	Ongoing disputes on making charges
MSMEs	Mixed	Benefit from lower rates, but face compliance costs



6.7 Impact on Household Expenditure

GST 2.0 is set to reduce household expenditure and lower the tax burden for various essential, educational, and health and hygiene items. The reduced taxes on soaps, shampoos, toothpaste, packaged and processed foods, notebooks, and medical supplies will directly reduce the expense incurred on a monthly basis. Lower- and middle-income households will benefit best with reduced prices as a share of their overall budget devoted to these items is larger than more affluent households. The reduced rates on discretionary expenditures, like electronics, appliances, and small automobiles, from 28% to 18% will improve affordability and may boost middle-class consumption patterns, particularly during seasonal festivals. Luxury goods and sin products will remain in high 40% tax slab, ensuring a greater share of the relief is focused on essential and mass consumption goods. Overall, GST 2.0 is likely to reduce effective household spending and increase purchasing power, thereby expanding equality of consumption patterns across care units, regardless of income group.

6.8 Impact on household Saving

GST 2.0 will most likely have a net positive impact on household savings by reducing expenditures for household necessities and providing more disposable income, lowering tax rates on food and other hundred's of items that are now used on a daily basis, and gives households relief on necessary expenditure for managing basic services instead of spending on discretionary items. Tax relief for everyday items likely means households will spend less on necessity items and have more room in their household budgets to save and spend on discretionary items. This is particularly true for middle-class families, who are now paying less for more affordable electronics and small cars, as this doesn't die into their monthly outflows. At the same time the keeping of luxury and sin goods in the highest slab, means that it is fairer, at least those that save through reducing indirect taxes are done proportionately, which will ultimately provide lower- to middle-income groups more net gains than higher-income groups. Over time, the small impact of reduced household budgets from the impacts of indirect taxes allows the GST 2.0 policy to potentially provide opportunities to support higher household savings on aggregate, which is not only beneficial to household financial, but also to long-term economic growth.

7. Conclusion

GST 2.0 is a huge step closer to a simpler, and more efficient indirect tax regime in India. In the near-term, there will still be challenges such as revenue leakage and higher compliance costs for SMEs, but the long-term benefits will lead to higher compliance levels, less contentious dispute resolution and an overall improvement in the ease of doing business. In essence, success will depend upon political consensus, timely compensation to the states and an effective support system for the taxpayers.

8. Policy Recommendations

The move from GST 1.0 to GST 2.0 is an opportunity to streamline the indirect tax system in India, improve compliance and building up revenue resiliency. However, to ensure a successful rollout and equitable outcomes, a phased approach is required. Slab rationalization must occur over a longer time horizon so that businesses and consumers have time to adjust. States will require strong and transparent compensation systems to make up for short-term revenue losses and in order to maintain cooperative federalism. From a business perspective, MSMEs would benefit from special funding support programs that include intensive training and free or subsidized compliance software so that the transition to digital can be facilitated and compliance costs and burdens are lessened. Building up public confidence in the GST system must also include investing greater effort in tax dashboard transparency to provide real-time revenue and compliance monitoring at the citizen level including dispute resolution opportunities. Lastly, there will need needed sectoral relief programs to address anomalies that exist in sectors like jewellery, real estate, or handicrafts as there are challenges that exist with current compliance and disputes. Collectively, these actions would advance efficiency while maintaining equity and federal equity and stability in hopes that with GST 2.0 we can move to a more transparent and growth-focused revenue system.

9. References

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