

## GST 2.0 – A Timely Reform for India's Economy

The Goods and Services Tax (GST), introduced in July 2017, was one of the most ambitious tax reforms in independent India. It replaced a complex web of central and state taxes with a single, unified tax system. After eight years of experimentation and adjustments, 2025 has witnessed another major milestone – GST 2.0 reforms, centered around rate rationalisation. These changes are not just about simplifying tax rates but are expected to impact India's economy, revenue patterns of the Union and states, and long-term fiscal stability.

### GST 2.0 Reforms

The GST Council in 2025 announced a significant rationalisation of tax slabs, to be implemented from September 22, 2025. The key changes include –

1. **Merging the 12% tax slab with 5%** → bringing down the median tax rate from 12% to 5%.
2. **Subsuming the 28% slab into 18%**, thus eliminating the higher slab for most goods.
3. **Introducing a 40% slab** for a limited set of luxury and demerit goods, replacing the earlier practice of adding cess over the 28% slab.
4. **Shifting some items to the nil rate**, making them tax-free to boost affordability.

This simplification effectively reduces the number of slabs and provides clarity to businesses and consumers. Importantly, the timing of the reforms – just ahead of the festive season – is expected to give an immediate boost to consumption.

### Impact on the Economy

The immediate effect of GST 2.0 will be felt in consumer demand and producer sentiment. Lowering the effective tax rate means many goods and services will become cheaper, encouraging households to increase spending. Producers, in turn, are expected to benefit from higher sales volumes, which may boost private investment in domestic consumption-driven sectors such as FMCG, retail, and automobiles. Additionally, the reforms have been carefully timed. By advancing the rollout to September 22 – ahead of Diwali – the government has reduced fears of deferred consumption that could have dented GDP growth in the second quarter. Instead, higher sales in the festive season are likely to lift growth momentum. At the same time, GST rationalisation will provide a counterbalance to external shocks, such as the imposition of US tariffs and penalties on Indian exports. While exporters may remain cautious in investing in fresh capacity, the domestic economy will draw strength from enhanced consumption, shielding overall growth to some extent.

### Impact on Union Government Revenues

From the perspective of the Union Government, GST is an important but not dominant contributor to revenues. The Central GST (CGST) accounts for less than one-fourth of the Centre's tax receipts. Moreover, a substantial part of CGST is shareable with states, as 41% of it is devolved under Finance Commission rules. The government has estimated that the rationalisation of rates will lead to a revenue foregone of around ₹48,000 crore in the second half of FY 2025–26, or ₹96,000 crore annually. Of this, the Centre's net loss is about ₹28,300 crore. While this is a sizable figure, it is comparable to the revenue foregone due to personal income tax reductions announced earlier in the Union Budget.

However, the Union Government is betting on the second-round effect of higher consumption, which could partly compensate for the initial revenue loss. Increased economic activity would, over time, generate more tax collections through higher volumes, even if rates are lower.

### Impact on States

The states are likely to be affected more significantly than the Centre. State GST (SGST) contributes over 40% of states' own tax revenue. According to budget estimates for 2025–26, states had projected SGST collections of ₹10.8 trillion, a 22% increase from the previous year. However, actual growth between April and August has been modest at 5.8%.

The new GST rates will further impact state revenues. It is estimated that of the total annualised revenue foregone of ₹96,000 crore, the **states' share will be about ₹67,700 crore**. This will not only affect their tax receipts but also reduce the **central devolution transfers**, since the Centre itself will collect less CGST.

For states already facing fiscal stress and revenue deficits, this loss may compel them to either –

1. Raise other sources of revenue (for example, excise on alcohol, property tax), or
2. Cut down on expenditure, especially developmental spending.

Therefore, while GST 2.0 is a progressive reform in terms of simplicity and growth, it places fiscal adjustment pressures squarely on the states.

### Long-Term Significance

Despite the short-term concerns on revenue, the **long-term benefits** of GST 2.0 are substantial –

1. **Simplification of the tax structure** – With fewer slabs, compliance becomes easier for businesses, especially MSMEs. Litigation over classification disputes is likely to reduce.
2. **Boost to consumption-led growth** – A lower effective median tax rate (from 12% to 5%) will support household demand, which is the backbone of India's GDP.
3. **Investment stimulus** – By improving business sentiment, rationalisation may encourage private sector investment, particularly in domestic-focused industries.
4. **Reduction in distortions** – The replacement of cess with a higher slab (40%) for luxury goods brings greater transparency.
5. **Cooperative federalism** – GST continues to be a joint venture between the Centre and states. Rationalisation requires both to balance fiscal prudence with growth imperatives, reinforcing cooperative federalism in practice.
6. **Global competitiveness** – A simplified GST system aligns India with best practices worldwide and strengthens the ease of doing business.

Over time, as consumption and compliance improve, the initial revenue loss may narrow, allowing both the Centre and states to reap the benefits of a more vibrant economy.

### Conclusion

The introduction of GST in 2017 was rightly described as a “watershed moment” in India's tax history. The GST 2.0 reforms of 2025 mark another landmark by rationalising rates, reducing slabs, and simplifying the structure. While the move entails a significant revenue sacrifice – particularly for states – its timely implementation during the festive season ensures that consumption demand and business sentiment receive a strong push. In the long run, GST 2.0 is expected to strengthen India's domestic growth model, promote investment, and reduce compliance complexities. For the Union and the states, the key challenge will be to manage fiscal balances in the short run while reaping the benefits of higher consumption and economic vibrancy in the future. GST 2.0 is not just a tax reform – it is a strategic bet on India's growth story.

### Mains Practice Question.

1. “Critically examine the GST 2.0 reforms of 2025 in terms of their impact on consumer demand, Union and State revenues, and long-term economic growth. Do the benefits outweigh the fiscal costs?”

#### Answering Guidelines

##### 1. Introduction (50–70 words)

1. Briefly define GST and highlight the significance of GST 2.0 reforms.
2. Mention the key change – rate rationalisation (12% merged with 5%, 28% into 18%, new 40% slab).

##### 2. Impact on Consumer Demand and Economy (150–200 words)

1. Cheaper goods → higher consumption, especially during festive season.
2. Boost to private investment in domestic sectors.
3. Helps offset negative impact of global trade tensions (e.g., US tariffs).
4. Short-term demand revival vs long-term consumption-led growth.

##### 3. Impact on Union Revenues (120–150 words)

1. CGST contribution and revenue foregone (~₹28,300 crore for Centre).

2. Effect on central devolution to states (41% shared).
3. Compensating factors - increased economic activity, higher compliance.

#### **4. Impact on States (150–200 words)**

1. SGST = ~40% of states' own tax revenue → heavy dependence.
2. Loss of ~₹67,700 crore projected; uneven impact across deficit vs surplus states.
3. May force states to either raise alternative revenues or cut developmental expenditure.
4. Tension between fiscal consolidation and growth.

#### **5. Long-Term Significance (120–150 words)**

1. Simplification of tax slabs reduces disputes and compliance burden.
2. Encourages consumption, investment, and ease of doing business.
3. Strengthens cooperative federalism despite fiscal stress.
4. Aligns India's GST with international best practices.

#### **6. Conclusion (50–70 words)**

1. Balanced view - Short-term revenue loss vs long-term systemic efficiency.
2. Stress that GST 2.0 is not just fiscal, but a growth-oriented reform.
3. Benefits outweigh costs if states and Centre manage fiscal prudence effectively.