Entering the age of GST

The long-term benefits of GST are clear — the challenge is to quickly address the short-term obstacles

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The Goods and Services Tax (GST) is in force from today. The reform, touted as a "game changer" and the "reform of the century", was deemed worthy of a launch on the midnight of June 30 in the Central Hall of the Parliament. Indeed, one is reminded of the famous speech by Pandit Jawaharlal Nehru on the midnight of August 14-15, 1947. He spoke of a "tryst with destiny", of "redeeming the pledge" and referred to India waking up to life and freedom when the whole world slept. Given the fanfare with which unveiling of the GST reform has been planned, it seems to be a reform with consequences never before seen in the country.

The enormous publicity that it has received and the great gains spoken about the 'one nation, one market, one tax' by both the government and the captains of industry have raised high expectations. However, there is palpable nervousness at both government and industry levels.

The country has waited for the reform for long, and I had once described implementation of the GST as the "bullock cart stuck in the mud". The discussion on the reform has spanned more than a decade and half, and the then Finance Minister, P. Chidambaram, in his Budget of 2007 spoke of implementing the levy from April 2010. Suddenly the mud seems to have dried and the bullock cart seems to have been powered with a Rolls-Royce engine!

Check the optimism

While the implementation of the GST reform is surely a cause to celebrate, one should not get carried away, for over-optimism on its favourable consequences builds expectations which may be difficult to fulfil. It must be noted that petroleum products are excluded and cascading on that account will continue – they contribute over 35-40% of revenue from indirect taxes.

With multiple rates, it is not a simple tax and robs much of the benefits from lower administrative, compliance and distortion costs. There will be classification disputes, and many of them will end up in courts. Having multiple rates is a sure invitation for lobbying. This also puts additional burden on administration, increases the compliance cost and the load-bearing capacity of technology needed for providing input tax credit with multiple rates by matching every invoice. Requiring the regular GST dealers to file 37 returns in a year raises anxiety, given an untested technology platform. Despite the assurances given, the anti-profiteering clause creates considerable apprehension. The requirement of e-way bills for inter-State movements has also been a cause of concern. Above all, there is a palpable fear of the unknown, given the recent disruptive experience with demonetisation. Indeed, any major tax reform could lead to disruption, and the complexity of the structure and the untested technology platform adds to the fear. Of course, a majority of retail traders, who buy and sell commodities and services within a State and have a turnover of less than ₹75 lakh, will come under the compounding system. They will pay a simplified tax at 1-2% on the turnover without the facility of availing or according input tax credit, and submit only quarterly returns.

How short is the short term?

It is clear that the GST reform will lead to significant disruption in the economy in the short term. How short is the short term depends on how well the transition is planned, and how fast the economic agents will adjust to the new normal. The disruptions caused by demonetisation continue to haunt large parts of the unorganised economy even as the economy had been substantially remonetised. It is very difficult to predict the impact of such disruptions and the discontent they create. The power loom sector has considerably suffered on account of one disruption, and with different tax rates proposed to be levied on yarn, fabrics and readymade garments, Tamil Nadu manufacturers are at war. Transporters will soon find that the tax paid on fuel cannot be credited against the GST payable on the transportation services rendered by them. There are concerns about the rates of tax, mandated compliances and glitches in transition, and investment activity is virtually at a standstill, with everyone waiting to see how the reform pans. Even as the tax is about to be unveiled, old decisions are changed and new decisions taken by the GST Council, and there is hardly any time to internalise them. The government could have used the time until September to provide greater clarity and test the technology through some dry runs to ensure a smoother transition.

Instead of viewing the GST as a game changer, it is useful to see it merely as the next stage of consumption tax reform in the country. To be sure, there will be disruptions, and this may actually contribute to some slowdown in the economy in the short term. The much-vaunted growth acceleration may happen only in the long term when the transaction cost of businesses comes down. The statement by the Union Finance Minister that there could be short-term pains for long-term gains is appropriate. The Revenue Secretary too has stated that this is a work in progress, and that is refreshing. Hopefully, his statement that the tax will be unified eventually to have one or two rates will be achieved soon. The objective of including real estate within a reasonable time period is welcome because besides expanding the tax base, this will help in fighting black money. It would be useful to simultaneously include petroleum products within the ambit of the GST, for the expanded base could offset the revenue loss due to the prevailing high rates on petroleum products.

Reducing the cost

The GST reform is an important reform. It is a major tax harmonisation exercise and will significantly reduce the transaction cost of doing business in India. It will unify multiple taxes into a single tax and reduce compliance and administrative cost in the long term, do away with levies like octroi and ensure a more unified market. It will reduce cascading on account of levies like octroi, purchase tax and central sales tax and make the economy more export-competitive. More importantly, it might see a significant increase in revenue productivity of income tax as the seeding of PAN in GST registration will make it difficult for businessmen to evade the tax. All these could contribute to acceleration in growth. To know how and when that will happen, we will have to wait and keep the fingers crossed.

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