



Impact of GST 2.0 Rationalisation on Indian Economy: Structural Reforms, Macroeconomic Outcomes, and Sectoral Dynamics

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Abstract

The Goods and Services Tax (GST), implemented in July 2017, represents a landmark indirect tax reform in India aimed at unifying the tax regime, eliminating cascading effects, and enhancing revenue buoyancy. Building upon this foundation, the introduction of GST 2.0 in September 2025 marks the most significant overhaul since its inception. Approved by the GST Council in its 56th meeting and effective from September 22, 2025, the reform rationalises the previous multi-slab structure (0%, 5%, 12%, 18%, and 28%) into a simplified two-slab system—primarily a 5% merit rate for essential goods and an 18% standard rate—with a 40% de-merit rate applied selectively to luxury and sin goods. Additional exemptions (Nil rate) were extended to critical items such as UHT milk, certain breads, life-saving drugs, and individual life/health insurance. This paper provides a comprehensive examination of the structural changes introduced under GST 2.0, its macroeconomic impacts on GDP growth, inflation, government revenue, employment generation, and formalisation, as well as sectoral dynamics across FMCG, automobiles, construction, MSMEs, textiles, and services. Drawing on official data from the GST Council, PIB, CBIC, RBI reports, MoSPI, Economic Surveys, and industry analyses up to mid-2026, the study evaluates early post-implementation trends. Preliminary evidence indicates positive impulses on consumption and economic growth, moderated inflationary pressures (estimated 30–90 basis points decline), and improved ease of doing business through reduced compliance burdens and fewer classification disputes. However, short-term revenue pressures, estimated net fiscal loss of around ₹45,000–93,000 crore (partially offset by higher volumes and the 40% slab), pose challenges for fiscal federal coordination. Long-term benefits are projected to materialise through enhanced tax buoyancy, supply chain efficiency, MSME competitiveness, and consumption-led growth, contingent upon effective benefit pass-through to consumers, robust compliance mechanisms, and seamless Centre-State fiscal arrangements. The reform's success will significantly influence India's trajectory toward a more efficient, inclusive, and resilient economy.

Keywords: GST 2.0, Tax Rationalisation, Indian Economy, Consumption-Led Growth, Fiscal Policy, MSMEs

Introduction

India's Goods and Services Tax (GST), implemented on July 1, 2017, stands as one of the most ambitious and transformative indirect tax reforms in the country's post-independence economic history. Conceived as a comprehensive value-added tax system, GST replaced a complex web of multiple central and state taxes—including Central Excise Duty, Service Tax, Value Added Tax (VAT), Entry Tax, Octroi, and several cesses—into a

single, unified national framework. This reform aimed to eliminate the cascading effect of taxes (tax-on-tax), create a seamless national market, reduce compliance burdens, and enhance overall economic efficiency. By subsuming most indirect taxes under one umbrella, GST sought to foster "One Nation, One Tax, One Market," a vision that promised to boost inter-state trade, improve supply chain logistics, and promote formalisation of the economy.

The journey toward GST was long and consultative. Discussions on a unified indirect tax system date back to the early 2000s, with the Kelkar Task Force on Indirect Taxes (2002) and subsequent recommendations by the Empowered Committee of State Finance Ministers playing pivotal roles. The Constitution (101st Amendment) Act, 2016, provided the legal foundation by enabling the levy of GST on supplies of goods and services. The GST Council, a federal body comprising the Union Finance Minister and state representatives, was established to ensure cooperative federalism in decision-making on rates, rules, and exemptions.

In its initial years, GST achieved notable successes. It significantly reduced tax cascading, streamlined compliance through a robust digital infrastructure (GSTN portal), and facilitated input tax credit (ITC) mechanisms that improved cash flows for businesses. Revenue performance has been particularly impressive. Gross GST collections reached a record ₹22.08 lakh crore in FY 2024-25, reflecting a 9.4% year-on-year growth and nearly doubling from earlier pandemic-affected years. Average monthly collections rose to ₹1.84 lakh crore, demonstrating strong buoyancy. The taxpayer base expanded dramatically—from approximately 6.5 million registrations at launch to over 15 million active taxpayers by 2025—signalling substantial formalisation of the economy. Studies indicate that GST contributed to narrowing the effective tax rate differentials across firms and encouraged documented input purchases, particularly among larger entities, with positive spillover effects on smaller suppliers.

Beyond revenue, GST promoted economic integration. Interstate barriers diminished, logistics costs reportedly fell in several sectors, and the system encouraged voluntary compliance through ITC linkages. Empirical evidence suggests positive contributions to GDP growth (estimates ranging from 0.5–2% in long-term efficiency gains), enhanced ease of doing business, and greater transparency via real-time tracking and data analytics. Sectors such as manufacturing, logistics, and e-commerce benefited from unified treatment across states.

However, despite these achievements, the original GST structure encountered persistent criticisms and operational challenges. The multi-slab rate structure—comprising 0% (exempt), 5%, 12%, 18%, and 28%, along with a compensation cess on sin and luxury goods—became a primary source of complexity. Classification disputes proliferated due to subtle differences in product descriptions, leading to numerous litigations and demands for advance rulings. Inverted duty structures (where input taxes exceeded output taxes) locked up working capital, especially in labour-intensive sectors like textiles, footwear, and pharmaceuticals. Compliance

burdens remained high for Micro, Small, and Medium Enterprises (MSMEs), with frequent filing requirements, reconciliation challenges, and delayed refunds straining resources. Many analysts argued that the multiplicity of rates undermined the core objective of simplicity, increasing administrative and transactional costs.

These issues prompted calls for “Next Generation” or GST 2.0 reforms. Expert committees, industry bodies, and economists advocated for rate rationalisation to minimise slabs, correct anomalies, and enhance neutrality. The GST Council responded progressively through reviews, but the most decisive step came in its 56th meeting held on September 3, 2025, in New Delhi. Chaired by Union Finance Minister Nirmala Sitharaman, the Council approved far-reaching recommendations for rate rationalisation and trade facilitation measures.

GST 2.0, effective from September 22, 2025, represents the most significant overhaul of India’s GST regime since its 2017 launch. The reform consolidates the tax structure into a simplified two-slab system: a 5% merit rate for essential and daily-use goods and an 18% standard rate for most other items. A special 40% de-merit rate applies to select luxury and sin goods (such as certain aerated drinks, tobacco products, pan masala, and high-end vehicles). Additionally, expanded exemptions (Nil rate) cover critical essentials like UHT milk, certain breads, life-saving drugs, and individual life/health insurance policies. Targeted rate reductions benefit key sectors including textiles, footwear, cement, automobiles (especially small cars and two-wheelers), farm machinery, and several services.

Approximately 99% of items previously in the 12% slab moved to 5%, while around 90% of those in the 28% slab shifted to 18%. This rationalisation directly addresses classification ambiguities and inverted duty issues. The timing—aligned with the festive season—aimed to stimulate consumption amid global uncertainties, including potential US tariffs and geopolitical tensions. The reform aligns with national priorities of consumption-led recovery, affordability for the common man, support for MSMEs and labour-intensive industries, and advancing India’s ease of doing business rankings.

This paper analyses the multifaceted impacts of GST 2.0. It examines structural changes in the tax architecture, macroeconomic outcomes on GDP growth, inflation, revenue buoyancy, employment, and formalisation. Sectoral dynamics across FMCG, automobiles, construction, real estate, MSMEs, textiles, healthcare, and hospitality receive detailed attention. Challenges such as short-term revenue pressures, benefit pass-through to consumers, federal coordination between Centre and States, and implementation hurdles are

critically evaluated. The analysis draws on official data from the GST Council, PIB, CBIC, RBI reports, Ministry of Statistics and Programme Implementation (MoSPI), Economic Surveys, industry analyses (e.g., SBI, ICRA), and early post-implementation trends up to mid-2026.

By evaluating early evidence alongside theoretical expectations, this study contributes to the evolving discourse on optimal tax design in emerging economies. While preliminary indicators suggest positive impulses on consumption, moderated inflation, and compliance efficiency, long-term success depends on effective monitoring, anti-profiteering enforcement, digital infrastructure strengthening, and cooperative federalism. As India aspires to become a developed economy (Viksit Bharat), GST 2.0 could serve as a critical enabler of sustainable, inclusive, and resilient growth.

Literature Review

The evolution of India's indirect tax system has been extensively documented in academic, policy, and institutional literature. Pre-GST studies consistently highlighted deep structural inefficiencies in the pre-2017 regime, while post-2017 analyses evaluated the initial GST's achievements and limitations. More recent works on rate rationalisation, culminating in GST 2.0 (effective September 2025), focus on potential macroeconomic multipliers, compliance gains, and fiscal trade-offs. This section synthesises key contributions, identifies research gaps, and positions the current study within the evolving discourse.

Pre-GST Regime: Inefficiencies and Reform Imperatives

Prior to July 1, 2017, India's indirect tax landscape was fragmented and distortionary. The system comprised multiple overlapping levies: Central Excise Duty, Service Tax, Central Sales Tax (CST), State VAT, Entry Tax, Octroi, and various cesses. This multiplicity created cascading effects (tax-on-tax), inter-state barriers, and high compliance costs. The **Kelkar Task Force on Indirect Taxes (2002)** and the subsequent Task Force on FRBM Act implementation (2004) were seminal in diagnosing these issues. The Kelkar Committee emphasised that the existing structure suffered from a narrow tax base, exclusion of services (which constitute over 50% of GDP), vertical fragmentation between Centre and States, and economic distortions that lowered productivity and growth.

Scholars such as Purohit (2009) and Kumar (2016) documented how divergent state VAT structures encouraged tax arbitrage and increased logistical costs. Businesses faced high compliance burdens due to manual processes, lack of seamless input tax credits across jurisdictions, and frequent litigation. Estimates

suggested that cascading taxes inflated costs by 20-30% in certain supply chains, particularly in manufacturing and logistics. Rao (2018) argued that these inefficiencies contributed to India's suboptimal tax-to-GDP ratio and hindered the creation of a unified national market.

International comparisons reinforced the case for reform. Experiences from countries like Canada, Australia, and Malaysia showed that well-designed VAT/GST systems could enhance efficiency, though initial compliance costs often rose for smaller firms before stabilising.

Post-2017 GST Implementation: Achievements and Shortcomings

The introduction of GST in 2017 was hailed as a landmark reform. Early assessments by institutions like **NITI Aayog**, **RBI**, and **NIPFP** noted significant positive outcomes. NITI Aayog studies (2018 onwards) estimated that GST contributed 0.5–2% additional GDP growth through better supply chain efficiency, reduced logistics costs (reportedly by over 30% in some sectors), and formalisation of the economy. The taxpayer base expanded from roughly 6.5 million to over 15 million active registrations by 2025, reflecting improved compliance.

Revenue performance strengthened over time. Gross collections reached a record ₹22.08 lakh crore in FY 2024-25, with monthly averages crossing ₹1.8 lakh crore. NIPFP working papers, including those by Sacchidananda Mukherjee, assessed buoyancy improvements, though the GST-to-GDP ratio for Centre and States did not immediately surpass pre-GST equivalent streams in some comparisons. RBI reports (2019–2025) highlighted greater revenue predictability, seamless inter-state trade, and positive effects on manufacturing and services GDP contributions (1–2% gains in several sub-sectors).

However, literature also flagged persistent challenges. Compliance costs for MSMEs were estimated at 3–10% of turnover, particularly burdensome for micro enterprises due to frequent filings, reconciliation issues, and delayed refunds. Inverted duty structures in sectors like textiles, footwear, and pharmaceuticals locked up working capital. Classification disputes proliferated under the multi-slab system (0%, 5%, 12%, 18%, 28% plus cess), leading to litigation and uncertainty. Studies on the unorganised sector (e.g., mixed-method research involving interviews in Uttar Pradesh, Maharashtra, and Tamil Nadu) revealed "bounded formalisation," where small firms adopted coping strategies like selective digitalisation or intermediaries rather than full compliance.

Empirical analyses using regression and simulation models (e.g., Bhanumurthy et al., 2018; NIPFP studies) confirmed positive but uneven impacts. While larger firms benefited from input tax credits, smaller entities faced regressive compliance burdens. Federal coordination through the GST Council was praised, yet concerns persisted regarding state fiscal autonomy and compensation mechanisms.

Theoretical Foundations and International Perspectives

The GST reform draws from optimal taxation theory (Ramsey, 1927) and public finance principles (Musgrave). A destination-based consumption tax minimises production distortions and promotes efficiency. International literature on VAT implementations (Cnossen, 2013; Keen & Lockwood, 2010) suggests strong revenue and welfare gains in federal systems when designed with simplicity and broad bases. Malaysia's GST experience (Kasipillai & Jabbar, 2006) mirrored India's: initial compliance spikes followed by buoyancy improvements.

Literature on Rate Rationalisation and GST 2.0

Anticipating GST 2.0, pre-implementation studies from **Economic Survey**, **SBI Research**, and independent economists projected substantial benefits from slab consolidation. SBI Research (2025) estimated that rationalisation could generate a consumption stimulus of ₹1–2 lakh crore through multipliers, with GDP boosts ranging from 20–70 basis points (some projections up to 100–120 bps over 4–6 quarters). Inflation moderation of 30–100 basis points (or higher, up to 1.1% in optimistic scenarios) was widely forecasted, contingent on benefit pass-through.

The shift to a two-slab system (primarily 5% and 18%, with 40% on select demerit goods) and expanded exemptions was expected to reduce classification disputes, correct inverted duties, and lower compliance costs. NIPFP Working Paper 444 (2026) by Mukherjee and Badola examined early post-GST 2.0 price movements, finding varied pass-through: stronger in consumer durables but incomplete in many food and household items.

Academic papers and think-tank reports (ORF, JETIR, IERJ, ResearchGate publications, 2025–2026) emphasise GST 2.0's role in boosting labour-intensive sectors (textiles, FMCG, construction, automobiles), supporting MSMEs, and enhancing ease of doing business. Projections include higher formalisation, employment generation, and export competitiveness. However, concerns about short-term revenue losses (estimates ranging from ₹45,000–93,000 crore net, partially offset by the 40% slab and volume growth) and state compensation remain prominent.

The **Economic Survey 2025-26** acknowledges GST 2.0 as a radical overhaul, linking it to broader goals of consumption-led recovery and resilience against global headwinds.

Research Gaps and Contribution of the Present Study

While pre- and immediate post-2017 literature is rich, comprehensive evaluations of GST 2.0 remain nascent due to the short post-implementation period (September 2025–mid-2026). Existing studies are largely predictive or focus on narrow aspects (e.g., price pass-through or sectoral impacts). There is limited integrated analysis combining macroeconomic outcomes (GDP, inflation, employment), sectoral dynamics, federal dimensions, and early empirical trends.

This study bridges these gaps by synthesising official data (GST Council, CBIC, RBI, MoSPI), industry reports (SBI, ICRA), and academic sources up to May 2026. It provides a balanced assessment of structural changes, positive impulses on consumption and efficiency, and challenges related to revenue neutrality and implementation. By incorporating early post-reform evidence, it contributes to the policy discourse on optimal tax design in large federal economies aspiring for sustained, inclusive growth.

Methodology

This is a descriptive-analytical study based on secondary data from GST Council, PIB, CBIC, RBI, MoSPI, Economic Surveys, SBI/ICRA/HDFC reports, and peer-reviewed papers. Quantitative projections use reported estimates; qualitative insights cover stakeholder perspectives. Limitations include the short post-implementation window (Sept 2025–May 2026) and data lags.

Macroeconomic Impacts of GST 2.0

The GST 2.0 rationalisation, implemented from September 22, 2025, represents a demand-side stimulus packaged within a structural tax reform. By simplifying the rate structure and reducing the tax burden on a wide range of consumption and investment goods, the reform influences key macroeconomic variables through both short-term demand channels and medium- to long-term supply-side efficiency gains. This section analyses its impacts on GDP growth, inflation, government revenue and fiscal deficit, and employment and formalisation, drawing on official estimates, RBI assessments, Economic Survey insights, and early empirical trends up to mid-2026.

GDP Growth

Economists and research institutions projected that GST 2.0 would add **20–70 basis points** to India's GDP

growth in FY26, primarily through consumption, which accounts for approximately 60% of India's GDP. Direct consumption stimulus from lower prices was estimated at around ₹70,000 crore in the initial phase, with Keynesian multiplier effects (ranging between 1.5 and 2.5 in the Indian context) amplifying the total impact to ₹1.98–2.4 lakh crore annually.

The timing of the reform—coinciding with the festive season—proved strategic. Lower taxes on FMCG items, consumer durables, automobiles, textiles, footwear, and construction materials (cement) boosted rural and urban demand. Several agencies revised their FY26 growth forecasts upward. EY raised its projection to 6.7% from 6.5%, while the World Bank adjusted to 6.5% citing strong domestic demand and GST 2.0 support. Some analyses, including Union Bank of India research, estimated a short-term boost of 10–20 bps in FY26, with medium-term gains potentially reaching 70–80 bps through sustained efficiency improvements.

Supply-side channels further supported growth. Simplified compliance, reduced classification disputes, and correction of inverted duty structures lowered logistics and transaction costs, enhancing supply chain efficiency. This particularly benefited MSMEs and labour-intensive sectors. Formalisation gains widened the tax base and improved resource allocation, contributing to productivity. Early high-frequency indicators, such as e-way bill generation, PMI manufacturing, and cement/steel consumption, showed resilience and momentum in Q3 and Q4 FY26.

Q1 FY26 GDP growth reportedly reached a robust 7.8%, partly attributed to the pre- and post-GST 2.0 consumption surge. Long-term efficiency gains from better supply chains, lower compliance costs (estimated reduction of 3–7% of turnover for small firms), and enhanced ease of doing business could yield a sustained 0.5–1% uplift in potential GDP growth over 3–5 years. However, external headwinds like US tariffs moderated the full potential. Overall, GST 2.0 acted as an effective counter-cyclical tool, cushioning global uncertainties while reinforcing domestic demand-led recovery.

Inflation

Rate rationalisation exerted clear downward pressure on prices. Projections for CPI inflation moderation ranged from **30–110 basis points**, depending on the extent of benefit pass-through to consumers. Optimistic estimates (e.g., Citi) suggested up to 1.1% moderation, while more conservative ones (SBI, ICRA) pointed to 25–60 bps in the first year.

Early post-September 2025 trends validated these expectations. Benign inflation was observed, aided by the festive timing and favourable base effects. Reductions on

essentials (soaps, toothpaste, packaged foods, UHT milk, certain breads) and inputs like cement directly lowered household and producer costs. Core inflation benefited from reduced logistics expenses and improved supply chains. ICRA noted that GST 2.0 could dampen headline CPI by at least 25–35 bps during Q3 FY26–Q2 FY27, potentially pulling the full-year average below 3.0%.

Pass-through effectiveness varied across sectors. It was stronger in competitive, organised segments (FMCG, consumer durables, automobiles) due to monitoring by the National Anti-Profiteering Authority and market pressures. In less organised segments, pass-through was partial, leading to some margin expansion for businesses. The 40% rate on sin and luxury goods had limited impact on headline CPI owing to their low weight in the consumption basket.

Lower input costs in construction, manufacturing, and services helped control second-round effects. Combined with supply-side measures (e.g., agricultural interventions), GST 2.0 contributed to price stability without compromising growth. This created space for monetary policy flexibility, supporting the broader growth-inflation balance.

Government Revenue and Fiscal Deficit

Revenue implications remain one of the most debated aspects of GST 2.0. The government estimated a **gross revenue loss** of around ₹93,000 crore on the prior base, partially offset by ₹45,000 crore from the 40% de-merit slab on luxury and sin goods, resulting in a **net loss** of approximately ₹48,000 crore (roughly 0.13–0.16% of GDP). The Centre's share of the net loss was projected at a modest ₹3,700 crore by some analyses (SBI). Other estimates ranged from ₹57,000–85,000 crore, depending on base assumptions.

Despite the rate cuts, FY26 collections showed resilience. Gross GST revenues remained stable or grew modestly on a like-for-like basis, with strong performance in imports and certain compliant sectors. Monthly collections continued to average above ₹1.8–2.0 lakh crore in several months, supported by higher volumes, improved compliance, and formalisation. SBI Research projected that overall FY26 GST revenue would exceed budget estimates due to buoyancy effects.

Buoyancy from higher economic activity—increased consumption, production, and reporting—helped mitigate static losses. Enhanced e-invoicing, data analytics, and reduced disputes broadened the tax base. However, states faced varying pressures depending on their consumption vs. production mix. Some states with higher reliance on SGST expressed concerns, necessitating robust compensation mechanisms or

greater fiscal autonomy in non-GST revenues.

On the fiscal deficit front, the short-term impact was manageable within the overall fiscal glide path. The government maintained prudence through expenditure rationalisation and non-tax revenue measures. Medium-term, if compliance and growth dividends materialise as expected, the reform could prove revenue-neutral or positive within 2–3 years. Risks remain if pass-through is incomplete or global conditions worsen, potentially requiring additional borrowing or spending cuts.

Employment and Formalisation

GST 2.0's employment impact operates indirectly through boosted demand and improved business conditions. Labour-intensive sectors such as textiles, garments, footwear, FMCG, construction, and automobiles received significant relief, supporting job creation. Lower costs and higher demand encouraged capacity expansion and hiring, particularly in MSMEs.

Simplified compliance reduced the regulatory burden on small businesses, promoting formalisation. The expanded taxpayer base and better ITC mechanisms encouraged previously unorganised entities to register, improving access to formal credit, markets, and social security. This "bounded formalisation" enhanced labour protections and productivity over time.

Indirect effects on employment include better infrastructure spending (enabled by stable revenues) and skill-aligned growth in services and manufacturing. However, gains may not be uniform—automation in some sectors could limit absorption rates. Complementary policies in skilling, labour reforms, and industrial policy remain essential for translating growth into quality employment.

Overall, early evidence suggests positive momentum in employment-generating sectors, with formalisation trends accelerating post-reform.

GST 2.0 delivered a balanced macroeconomic impulse—boosting growth and easing inflation while containing fiscal risks through dynamic revenue effects. Its success underscores the power of well-timed, simplification-focused tax reforms in a large emerging economy. Long-term outcomes will depend on effective implementation, monitoring of pass-through, and continued Centre-State coordination.

Sectoral Impacts

GST 2.0 rate rationalisation, effective from September 22, 2025, has produced varied but largely positive impacts across key sectors of the Indian economy. By moving to a simplified two-slab structure (primarily 5% merit and 18% standard rates, with a 40% de-merit rate on

select luxury and sin goods), the reform has lowered tax incidence on essentials and mass-consumption items, corrected inverted duty structures, and reduced compliance complexities. This section examines the differential effects on major sectors, drawing on early post-implementation data, industry reports, and analyses up to mid-2026.

FMCG and Consumer Goods

The Fast-Moving Consumer Goods (FMCG) sector emerged as one of the clearest winners from GST 2.0. Numerous daily-use items—such as soaps, shampoos, toothpaste, hair oil, chocolates, biscuits, packaged foods, and mineral water—shifted from 12% or 18% to the 5% slab. Staples like certain breads, UHT milk, and other essentials received Nil or 5% rates. These reductions translated into lower retail prices and boosted volume growth, particularly in rural and semi-urban markets.

Companies like Hindustan Unilever (HUL), Nestlé, Britannia, ITC, and Dabur reported improved offtake in Q3 and Q4 FY26. Volume growth in personal care and packaged foods segments accelerated by 8–15% in several categories during the festive and post-festive quarters. Lower input costs and corrected tax structures also improved margins for manufacturers while enabling competitive pricing. The sector benefited from higher consumption elasticity among lower- and middle-income households. However, challenges included transitional inventory losses for pre-reform stock and the need for robust anti-profiteering compliance. Overall, FMCG witnessed a demand surge that supported broader consumption-led recovery.

Automobiles and Consumer Durables

The automobile industry received a significant boost, especially in the mass-market and two-wheeler segments. GST on small cars (petrol up to 1200cc, diesel up to 1500cc), motorcycles up to 350cc, three-wheelers, buses, trucks, and most auto parts declined from 28% to 18%. This enhanced affordability and stimulated demand in rural and semi-urban areas, where two-wheelers and entry-level cars dominate.

Two-wheeler manufacturers (Hero MotoCorp, Bajaj Auto) and passenger vehicle makers (Maruti Suzuki, Hyundai) reported strong sales growth in the October 2025–March 2026 period. Consumer durables such as air conditioners, TVs, refrigerators, and dishwashers also benefited from the shift to 18%, driving premiumisation and higher volumes in organised retail. Early data showed 12–20% year-on-year growth in select categories during the festive season. The reform supported the shift toward organised market share and aided export competitiveness by lowering costs. Larger luxury

vehicles and certain high-end models moved to the 40% slab, moderating demand at the premium end but generating targeted revenue.

Real Estate and Construction

Lower GST on cement (28% to 18%) and related inputs (e.g., marble, granite blocks, sand-lime bricks, bamboo flooring) reduced project costs by an estimated 3–5%. This provided relief to the real estate sector, particularly affordable housing, and supported the government's infrastructure push. Construction activity picked up momentum, with improved working capital cycles for developers due to corrected inverted duties.

Analysts noted increased project launches and higher absorption rates in Tier-2 and Tier-3 cities. The sector's linkage with employment generation amplified the reform's broader economic benefits. However, benefits were partially moderated by sticky labour and land costs. Overall, GST 2.0 contributed to easing supply-side bottlenecks in housing and infrastructure development.

MSMEs and Textiles/Footwear

Micro, Small, and Medium Enterprises (MSMEs) gained substantially from simplified compliance, reduced classification disputes, and lower rates. In textiles, man-made fibres and yarns moved to 5%, while readymade garments up to ₹2,500 per piece attracted 5% GST. This corrected long-standing inverted duty structures, unlocked working capital, and improved competitiveness for exporters.

The footwear sector also benefited from rate reductions, enhancing affordability and demand. MSMEs reported easier access to input tax credits and faster refunds, fostering formalisation. Many small manufacturers expanded capacity or entered export markets more confidently. Early surveys indicated improved sentiment and order books in labour-intensive clusters like Tirupur, Surat, and Agra. The reform addressed a key pain point for the sector, which employs a large share of India's workforce.

Healthcare and Insurance

Exemptions or reductions on life-saving drugs, certain medicines (from 12% to Nil/5%), and individual life/health insurance policies enhanced affordability. This improved access to healthcare for middle- and lower-income groups. Pharmaceutical companies benefited from lower tax incidence on inputs, while the insurance sector saw mixed effects—some segments gained from exemptions, though transitional compliance adjustments created temporary challenges. Overall, the reform aligned with goals of affordable healthcare and financial protection.

Hospitality and Services

Lower rates on hotel rooms, restaurants (in certain categories), gyms, and related services stimulated spending in the hospitality and tourism sector. Reduced costs encouraged both domestic and inbound tourism, supporting recovery in post-pandemic travel. Service-oriented MSMEs benefited from simpler filing and lower effective tax burdens, boosting activity in wellness, education, and entertainment services.

Sin and Luxury Goods

Select luxury items and sin goods (certain aerated drinks, tobacco products, pan masala, high-end vehicles) moved to a 40% rate. This curbed excessive consumption of demerit goods while generating additional revenue to partially offset losses from merit rate cuts. Demand in these categories moderated, but the impact on overall collections remained limited due to their smaller share in the consumption basket.

Agriculture and Allied Sectors

Farmers and the agri-input sector gained from reduced GST on tractors, farm machinery, irrigation equipment (12% to 5%), and key fertiliser inputs (sulphuric acid, nitric acid, ammonia from 18% to 5%). Lower costs improved farm mechanisation and productivity. Allied sectors like food processing benefited from cheaper inputs and exemptions on certain staples, strengthening the farm-to-fork value chain.

Overall Assessment and Inter-Sectoral Linkages

GST 2.0 created positive spillovers across sectors. Boosted FMCG and auto demand supported logistics and transportation (with lower rates on commercial vehicles). Construction and real estate growth created jobs, aiding consumption. MSME revival enhanced export potential and formal employment. Challenges included transitional inventory management, uneven pass-through of benefits, and short-term pressures on some state revenues. Sectors with high unorganised components saw slower adjustment compared to organised players.

By mid-2026, early indicators—such as improved PMI, higher e-way bills in beneficiary sectors, and corporate earnings reports—confirmed a demand revival, particularly in consumption and investment-linked industries. The reform reinforced India's manufacturing and services competitiveness while promoting inclusive growth.

Challenges and Risks

While GST 2.0 rationalisation offers substantial potential for economic efficiency, consumption-led growth, and

simplification, its implementation has introduced several multifaceted challenges and risks. These span fiscal, operational, institutional, and political dimensions. Short-term transitional frictions, if not managed effectively, could undermine public trust and the reform's long-term objectives. This section critically examines the primary risks identified in official assessments, industry feedback, and early post-implementation trends up to mid-2026.

Revenue Shortfalls and Fiscal Pressures

One of the most immediate concerns surrounding GST 2.0 is the potential for short-term revenue shortfalls. Government estimates placed the gross revenue loss at approximately ₹93,000 crore on the pre-reform base, partially offset by ₹45,000 crore from the new 40% demerit slab on luxury and sin goods, resulting in a net loss of around ₹48,000 crore (roughly 0.13–0.16% of GDP). Some independent projections, including those from Ambit Capital, suggested higher losses ranging from ₹70,000 crore to ₹1.8 lakh crore annually, depending on volume growth and compliance buoyancy.

The Centre's share of the net loss appears relatively contained (around ₹3,700 crore according to some analyses), but states bear a disproportionate burden. Many states derive a larger portion of their revenue from GST compared to the Centre. Early data from FY26 showed continued collection growth due to higher volumes and formalisation; however, buoyancy has not fully offset the rate cuts in all jurisdictions. Industrialised and consumption-heavy states have expressed greater concerns about revenue trajectories.

The broader fiscal context exacerbates these pressures. The GST compensation guarantee to states (14% annual growth) expired in June 2022, creating a "fiscal cliff." Although the compensation cess was extended until March 31, 2026, primarily to service Union borrowings from the pandemic period, its proceeds no longer directly stabilise state revenues in the same manner. States such as Punjab (49.6% shortfall in some periods), Uttarakhand, and Kerala have faced significant gaps. GST 2.0 has intensified calls for extended or new compensation mechanisms, with some opposition-led states warning of cumulative losses exceeding ₹2–2.5 lakh crore.

If economic buoyancy underperforms due to global headwinds (e.g., US tariffs) or incomplete pass-through, the risk of higher fiscal deficits at both Centre and state levels increases. This could constrain capital expenditure, social welfare programmes, and infrastructure push, potentially creating a feedback loop of slower growth and weaker revenues.

Pass-Through and Anti-Profitteering Challenges

Ensuring that tax rate reductions translate into lower prices for consumers remains a critical implementation risk. Section 171 of the CGST Act mandates commensurate benefits be passed on to recipients, but enforcement mechanisms have weakened. The National Anti-Profitteering Authority (NAA) effectively sunsetted for new complaints from April 1, 2025, with pending cases shifting to the GST Appellate Tribunal (GSTAT). For GST 2.0's September 2025 rate changes, no dedicated robust monitoring body was immediately revived, creating a significant enforcement vacuum.

Businesses face practical difficulties in determining "commensurate reduction" amid fluctuating input costs, multi-layered supply chains, and transitional inventory issues. While competitive sectors (FMCG, durables) showed reasonable pass-through through price cuts or quantity increases, fragmented and unorganised markets exhibited delays or partial benefits. Consumer surveys post-September 2025 revealed widespread scepticism, with many doubting meaningful relief on everyday items.

The absence of clear, sector-specific guidelines or safe harbour rules has increased uncertainty and litigation risks. Without strong anti-profitteering oversight, there is a danger that businesses — especially those with market power — may retain benefits as higher margins rather than passing them on. This could erode public support for the reform and undermine its consumption-stimulating objectives. Discussions about temporarily reviving anti-profitteering provisions for a 1–2 year transition period highlight the tension between over-regulation (which raises compliance costs) and under-regulation (which risks consumer welfare).

Implementation and Compliance Disruptions

Transitional disruptions have been particularly pronounced for smaller businesses. Although GST 2.0 simplifies the rate structure and reduces classification disputes, the immediate aftermath required repricing, system updates, inventory revaluation, and revised invoicing across millions of SKUs. MSMEs, which often lack sophisticated ERP systems or dedicated compliance teams, faced higher relative burdens. Challenges include working capital constraints from pre-reform high-taxed inventory, reconciliation of input tax credits, and adapting to new filing nuances.

Digital infrastructure issues persist. Occasional GSTN portal glitches during peak periods continue to affect smaller taxpayers. While e-invoicing expansion and data analytics aid larger firms, many micro enterprises still rely on accountants or intermediaries, increasing costs.

Compliance costs for MSMEs, historically estimated at 3–10% of turnover, may have declined marginally but remain significant during the adjustment phase.

Risks include temporary slowdowns in business activity, errors leading to notices, and uneven adaptation across regions. Capacity-building programmes and phased implementation support have helped, but gaps in digital literacy and awareness persist in rural and semi-urban areas.

Federal Tensions and Centre-State Coordination

GST 2.0 has tested the cooperative federalism model embedded in the GST Council. States surrendered significant tax autonomy in 2017 in exchange for revenue stability guarantees that have since lapsed. Rate rationalisation decisions, while taken collectively, disproportionately impact state finances because SGST forms a major revenue source for many. Industrial states and those with higher consumption bases have voiced stronger reservations about uncompensated losses.

Tensions revolve around compensation post-March 2026 cess sunset, sharing of cess proceeds, and potential state-level cesses on sin goods. Some states have demanded multi-year guarantees or greater flexibility to levy additional revenues. These debates risk delaying future reforms and eroding trust in the Council's decision-making process. Effective resolution requires transparent, formula-based compensation mechanisms and greater fiscal autonomy in non-GST areas for states.

Sectoral Imbalances and Other Risks

Certain sectors have faced temporary burdens or uneven benefits. The insurance industry, for instance, benefited from exemptions on individual life and health policies (reducing premiums and boosting penetration), but faced transitional challenges in system recalibration, policy re-issuance, and loss of input tax credits in some segments. Smaller insurers and group policies experienced differential impacts.

Other services sectors reported short-term margin pressures or compliance adjustments. Luxury and sin goods under the 40% slab saw demand moderation, affecting related industries. Agriculture and allied sectors gained from cheaper inputs, but benefits depend on effective supply chain transmission.

Broader risks include inflationary expectations if pass-through is uneven, potential rise in litigation at GSTAT, and political backlash if consumer benefits are not visibly delivered. Global factors (tariffs, commodity prices) could amplify domestic vulnerabilities.

GST 2.0's challenges are transitional yet significant. Revenue shortfalls, enforcement gaps in anti-profiteering,

compliance burdens on MSMEs, federal tensions, and sectoral frictions represent manageable but critical risks. Addressing them through targeted compensation, clearer guidelines, capacity building, and strengthened cooperative federalism will determine whether the reform delivers sustained benefits or faces credibility issues. Proactive monitoring and adaptive policymaking remain essential.

Policy Recommendations

Strengthen Monitoring Mechanisms for Benefit Pass-Through

Effective anti-profiteering enforcement remains critical to maintain public trust. The government should establish a time-bound, dedicated **GST Benefit Pass-Through Monitoring Cell** under the CBIC or empower the GST Appellate Tribunal (GSTAT) with specialised benches for a period of two years. This cell should develop clear, sector-specific guidelines and safe harbour rules for calculating "commensurate reduction," accounting for input cost variations, supply chain margins, and transitional inventory.

Technology-driven solutions must be prioritised. The GSTN portal should integrate AI-powered price monitoring tools that analyse bulk transactional data, retail price indices, and corporate filings to flag potential non-compliance proactively. Mandatory quarterly disclosures by businesses with turnover above ₹50 crore, coupled with random audits for smaller entities, would enhance deterrence without overburdening MSMEs. Consumer awareness campaigns through digital platforms, alongside a simplified, mobile-friendly complaint mechanism, would empower end-users. Stronger coordination between the National Consumer Helpline, state authorities, and industry associations is essential to balance enforcement with ease of doing business.

Enhance Digital Infrastructure and Capacity Building for MSMEs

MSMEs constitute the backbone of the Indian economy but often face disproportionate compliance challenges. The government should launch a comprehensive **GST 2.0 MSME Empowerment Programme** focusing on three pillars: digital upgradation, financial support, and skill development.

This includes expanding the scope of free accounting software and e-invoicing tools with voice-enabled interfaces in regional languages. Subsidies or interest-free loans for ERP system adoption, coupled with mandatory but staggered compliance training through district-level GST Kendras, would ease the transition. Collaboration with industry bodies such as FICCI, CII, and state MSME departments could facilitate peer-learning clusters in industrial hubs like Tirupur, Surat, and Coimbatore.

Furthermore, extending the composition scheme threshold and simplifying return filing (e.g., quarterly returns with monthly payment options for smaller taxpayers) would reduce the compliance burden. A dedicated helpline and grievance redressal portal with faster resolution timelines (under 15 days) should be institutionalised.

Transparent and Predictable Compensation for States

Federal trust is the cornerstone of GST's success. The Centre must design a transparent, formula-based compensation mechanism for states covering at least the next three financial years (FY27–FY29). This framework should account for revenue shortfalls attributable to GST 2.0 rate rationalisation, using a combination of GST compensation cess proceeds, additional devolution from the divisible pool, and performance-based incentives for states improving their own tax administration.

An independent expert committee, comprising representatives from the Finance Commission, NITI Aayog, and state nominees, should periodically review revenue performance and recommend adjustments. Greater fiscal autonomy for states in non-GST areas (e.g., stamp duty rationalisation, electricity duty) would reduce dependency and political friction within the GST Council. Regular publication of state-wise revenue impact reports would enhance accountability and cooperative federalism.

Roadmap for Further Simplification and Integration with Direct Taxes

GST 2.0's two-slab structure (with 40% on demerit goods) is a major improvement, but India should gradually move towards a **single standard rate** (ideally 12–15%) over the next 5–7 years, with a narrow list of exemptions and sin goods. A phased approach—beginning with merging the 5% and 18% slabs for non-essential items—should be announced with a clear timeline to provide policy certainty to businesses.

Simultaneously, deeper integration between GST and direct taxes (Income Tax and Corporate Tax) must be pursued. Measures such as unified taxpayer identification, shared compliance portals, common return filing schedules, and data exchange protocols between GSTN and the Income Tax Department would reduce duplication and improve overall tax governance. The long-term vision should be a **Unified Tax Administration Framework** that minimises taxpayer interface while maximising transparency through data analytics.

Institutionalise Data-Driven Future Adjustments

Future GST Council decisions should be firmly anchored in empirical evidence. The Council should commission

annual impact assessment studies through independent institutions (NIPFP, ICRIER, or NITI Aayog) covering macroeconomic outcomes, sectoral performance, compliance costs, and distributional effects. A permanent **GST Research and Analysis Unit** should be established to generate real-time dashboards on key metrics such as buoyancy, pass-through rates, formalisation progress, and litigation trends.

Adjustments to rates, exemptions, or procedures should follow a structured review cycle every 18–24 months, based on robust data rather than ad-hoc demands. This evidence-based approach would enhance the credibility and adaptability of the tax regime.

Conclusion

GST 2.0 rationalisation, implemented in September 2025, marks a citizen-centric evolution of India's tax architecture. By addressing long-standing issues of complexity, classification disputes, and inverted duty structures through a simplified rate framework, the reform has prioritised simplicity, consumption, and inclusivity. Early indicators up to mid-2026 are encouraging: consumption stimulus, moderated inflationary pressures, revival in labour-intensive sectors, and improved ease of doing business collectively suggest that the reform is delivering on its core objectives.

The projected GDP boost of 20–70 basis points in FY26, combined with benefits to FMCG, automobiles, construction, MSMEs, and textiles, demonstrates the power of well-designed indirect tax reforms in supporting demand-led recovery amid global uncertainties. While short-term revenue pressures and implementation challenges are real, dynamic buoyancy from higher volumes, formalisation, and compliance gains is expected to mitigate much of the static loss over the medium term.

However, sustained success is not automatic. It hinges on vigilant implementation, effective benefit pass-through to consumers, seamless Centre-State coordination, and continuous adaptation based on emerging data. The reform's true test lies in whether it can translate into visible gains for ordinary citizens — lower prices on essentials, more jobs in manufacturing and services, and a less burdensome tax environment for small businesses.

As India aspires to become a developed nation (Viksit Bharat) by 2047, GST 2.0 represents a critical milestone in building a modern, efficient, and equitable economic foundation. It reinforces the principle that tax policy must serve as an instrument of growth and inclusion rather than mere revenue collection. With prudent policymaking, robust institutional mechanisms, and stakeholder collaboration, GST 2.0 can become a model

for emerging economies navigating the complexities of federal taxation in the 21st century.

The journey from the fragmented pre-2017 tax regime to the unified and now rationalised GST system reflects India's maturing fiscal federalism. If the recommendations outlined above are implemented with urgency and sincerity, GST 2.0 will not only consolidate the gains of 2017 but also propel India towards a more resilient, competitive, and inclusive economy. The success of this reform will be measured not just in revenue figures or GDP growth numbers, but in its ability to improve the daily economic lives of 1.4 billion Indians.

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