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Short term impact of GST on Indian Economy : with GDP as focal point

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ABSTRACT

The differential multiple tax regime across sectors of production leads to distortions in allocation of resources thus introducing inefficiencies in the sectors of domestic production. Efficient allocation of productive resources and providing full tax offsets is expected to result in gains for GDP. In sum, implementation of a comprehensive GST in India is expected to lead to efficient allocation of factors of production thus leading to gains in GDP. Terming the first quarter GDP data as a matter of concern, the govt. Requires both in policy and investment to work to improve the figure. A detailed analysis shows that while agriculture is in the normal range, manufacturing has bottomed out to 1.6 percent from 3.1 percent.

The economic survey had projected a growth of 6.75 per cent to 7.5 per cent for 2017-18. The Indian economy expanded 5.7 percent year-on-year in the second quarter of 2017, below 6.1 percent in the previous period and market expectations of 6.6 percent. It remains the weakest growth rate since the first quarter of 2014 due to a slowdown in consumer spending and exports. On the production side, manufacturing and agriculture eased. GDP Annual Growth Rate in India averaged 6.12 percent from 1951 until 2017, reaching an all time high of 11.40 percent in the first quarter of 2010 and a record low of -5.20 percent in the fourth quarter of 1979.

Economic growth plunged to 5.7 per cent in April-June of the current financial year 2017-18 due to destocking by companies following pre GST fears. Growth in manufacturing declined to 1.2 per cent in April-June from 5.3 per cent in January-March.

Key words-: *GST, GDP, Destocking, Pre GST Fears, Economic Growth.*

I. INTRODUCTION

GST is one indirect tax for the whole nation, which will make India one unified common market. GST is a single tax on the supply of goods and services, right from the manufacturer to the consumer. Credits of input taxes paid at each stage will be available in the subsequent stage of value addition, which makes GST essentially a tax only on value addition at each stage. GST is essentially a consumption tax and is levied at the final consumption point. The principle used in GST taxation is Destination Principle. It is levied on the value addition and provides set offs. As a result, it avoids the cascading effect or tax on tax which increases the tax burden on the end consumer. It is collected on goods and services at each point of sale in the supply line. The GST that a merchant pays to procure goods or services can be set off later against the tax applicable on supply of goods and services.

GDP is a very strong measure to gauge the economic health of a country and it reflects the sum total of the production of a country and as such comprises all purchases of goods and services produced by a country and services used by individuals, firms, foreigners and the governing bodies. It is used as an indicator by almost all the governments and economic

decision-makers for planning and policy formulation. The Gross Domestic Product in the country like India is experiencing a faster rate of growth in the recent years. With regards to the composition of GDP, the percentage shares of various sectors have largely changed. The percentage share of the agriculture in the total GDP has declined, on the contrary the percentage share of services in the GDP is rising faster. With this shift, the Indian economy which was considered, by and large, to

be agriculture based economy but with the opening up of the economy post economic reforms of 1991.

II. LITERATURE REVIEW

If we talk about Indian economy we find that Indian economy is highly affected by indirect tax. In Indian economy direct tax like income tax, corporate tax etc. directly affecting the economy with raising in tax slab of income tax but if we talk about the indirect tax like service tax, vat tax, duties, sales tax (state and central) they all affecting Indian economy in different area because most of indirect tax applied by state government in their particular state and that make differentiation in the form of rate of indirect taxes. The GST (Goods and Service Tax) is one tax system government thinks to apply in place on all indirect taxes to centralize all the taxes in different state in India. The concept came from the European countries where many of country adopted the concept of one tax policy in all sales and services and that make the system very transparent

1. **(Cnossen, Sijbren,2013)** A modern Goods and Service tax (GST) would do much to alleviate the problems of India's current indirect tax system which is a serious impediment to the formation of a single common market and further economic growth. The Centre and the States should both have access to the full GST base. Last but not least, the system of taxation by classification and valuation should be replaced by a self-assessment system mainly monitored through checks upon books of account.
2. **Herekar, (2012)**The Ministry of Finance had set up the Task Force with Mr. V. Kelkar as the chairman of the Task Force. The main task of the Task Force was to evaluate the impact of the proposed GST on the Indian economy. The author in the paper has studied the different parts of GST and their impact on the common man, the business and the economy. The author has concluded based on secondary data that if GST is introduced in India, it would have a positive impact on the overall economy.
3. Arun Jaitly(2017) , Finance Minister told – Global economy is improving faster than what we thought and that is a positive trend. With reforms continuing, the confidence in the economy globally being high , the FDI inflow will continue. He has

also explained that” the April-June quarter GDP growth of 5.7 per cent is a matter of concern. We really require to work on both in terms of policy and investment- to improve upon these figures.”

4. Pronab Sen,(2017) Former chief statistician- “There is a mix impact of demonetisation and De stocking due to pre GST fears on GDP growth. The issue is a genuine demand-side problem created by external markets to a large extent and dim investments.”
5. T C A Anant,(2017) chief Statistician-Twin factors – de-stocking before the goods and services tax (GST) implementation and rise in whole sale inflation of inputs pulled down economic growth during the first quarter of FY18.

III. OBJECTIVES OF THE STUDY

- 1- To study the importance of GST on growth of Indian Economy.
- 2- To study the short term impact of Pre GST fears on GDP.
- 3- To analyse the reason of slumps down of GDP in Q1 2017-18.
- 4- To forecast the long term GDP growth rate.

IV. METHODOLOGY

Being an explanatory and conceptual research it is based on secondary data of journals, articles, newspapers and magazines. Considering the objectives of study descriptive type research design is adopted to have more accuracy and rigorous analysis of research study. The accessible secondary data is intensively used for research study.

V. IMPACT OF GST ON GDP GROWTH RATE

The Goods and Services Tax has been rolled out on 1st Jul 2017. Two key benefits are expected from this reform. Firstly, breaking down inter-state tax barriers and removing the cascading impact of taxation should lower business costs, improve competitiveness and boost growth. Secondly, a simplified and transparent tax regime should attract investment, improve revenues, widen the tax base and ensure compliance.

The impact is expected to be mixed in the near-term but beneficial in the medium to long-term. This reform will be a litmus test for the government as the economy

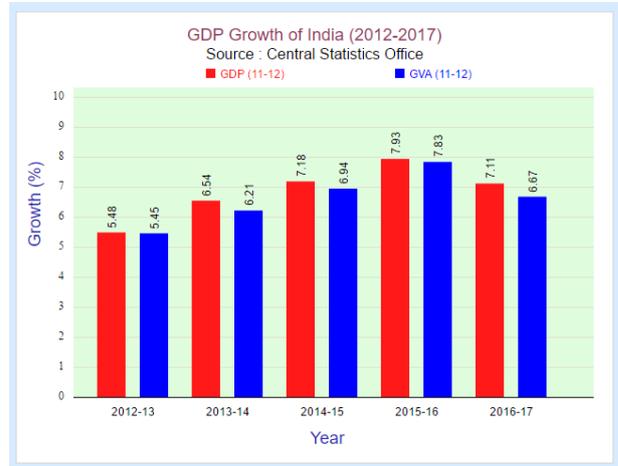
begins another phase of adjustment, just as activity had begun to stabilise after post-demonetisation dip.

Given the scale of the changes, implementation will be challenging. The extent of readiness amongst businesses, consumers and the collection network will be the biggest challenge apart from the regulatory machinery. The government believes that some 80% of businesses (using the previous tax system) have already registered for the new GST network. Most large companies are geared up but the same is not true of small and mid-sized firms, especially in the unorganised sector.

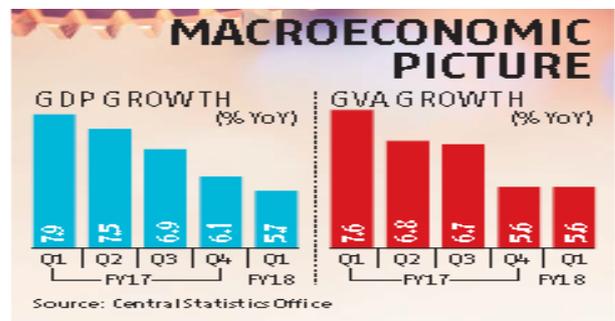
Teething issues are to be expected but should fade in subsequent months. As a start, the government has extended the deadline for tax filings by two months. An anti-profiteering authority will also be formed. More such fine-tuning and supportive measures are likely to minimise post-implementation hiccups.

- There will be one tax rate for all which will create a unified market in terms of tax implementation and the transaction of goods and services will be seamless across the states.
- The same will reduce the cost of transaction. In a survey, it was found that 10-11 types of taxes levied on the road transport businesses. So the GST will be helpful to reduce transportation cost by eliminating other taxes.
- As the GST vehicle is completely moving on robust IT mechanism, all return filing , different ledgers, payments and also ITC was done without any time constraint. There is very less interference of govt officials.
- After GST implementation the export of goods and services will become competitive because of nill effect of cascading effect of taxes on goods and products. In a research done by NCAER it was suggested that GST would be the key revolution in Indian Economy and it could increase the GDP by 0.9 to 1.7 percent. As speculated earlier, the tax experts can now assume that the growth will be around 1 to 2 percent after the implementation of the GST.
- GST will be more transparent in comparison to the VAT regime so it will generate more

revenue to the Government and will be more effective in reducing corruption at the same time. Overall GST will improve the tax Compliances.



Source- <http://statisticstimes.com/economy/gdp-of-india.php>



STATEMENT 2: QUARTERLY ESTIMATE OF EXPENDITURES OF GDP IN Q1 (APRIL-JUNE) OF 2017-18 (at 2011-2012 prices)

Item	APRIL-JUNE(Q1)			RATES OF GDP (%)	
	Expenditures of Gross Domestic Product for Q1 (₹ crore)			2016-17	2017-18
	2015-16	2016-17	2017-18		
1. Private Final Consumption Expenditure (PFCE)	1453347	1575613	1680481	53.6	54.0
2. Government Final Consumption Expenditure (GFCE)	286327	333761	391080	11.3	12.6
3. Gross Fixed Capital Formation (GFCF)	849973	912768	927506	31.0	29.8
4. Change in Stocks	67160	73118	73979	2.5	2.4
5. Valuables	40244	34687	105716	1.2	3.4
6. Exports	583423	594947	602159	20.2	19.4
7. Less Imports	623959	620649	703827	21.1	22.6
8. Discrepancies	69359	37601	33052	1.3	1.1
GDP	2725873	2941946	3110145	100.0	100.0
GDP (% change over previous year)		7.9	5.7		

Source- Central Statistical Office

STATEMENT 4: QUARTERLY ESTIMATE OF EXPENDITURES OF GDP IN
Q1 (APRIL-JUNE) OF 2017-18
(at current prices)

Item	APRIL-JUNE(Q1)				
	₹(crore)			RATES OF GDP (%)	
	2015-16	2016-17	2017-18	2016-17	2017-17
1. Private Final Consumption Expenditure(PFCE)	1823568	2042054	2226885	57.4	57.3
2. Government Final Consumption Expenditure(GFCE)	357350	433530	519320	12.2	13.4
3. Gross Fixed Capital Formation (GFCF)	978519	1036732	1068642	29.2	27.5
4. Change in Stocks	74613	81641	83610	2.3	2.2
5. Valuables	44737	37948	108658	1.1	2.8
6. Exports	671293	687415	708680	19.3	18.2
7. Less Imports	757976	746878	860680	21.0	22.2
8. Discrepancies	28174	-17506	28666	-0.5	0.7
GDP	3220278	3554938	3883781	100.0	100.0
GDP (% change over previous year)		10.4	9.3		

Source- Central Statistical Office

ECONOMIC IMPACT

The impact of GST may be mixed in the short-term but should be beneficial in the medium to longer-term. Highlights include:

a) Various domestic and international agencies have estimated GST's impact on India's growth. Most of these estimates are focused on the long-term, with near-term activity likely to be temporarily hurt by delayed consumption/ investment decisions. Few of the businesses which were previously outside the tax scanner now fall within. Manufacturers and retailers/wholesalers are in midst of clearing stock ahead of the rollout. Service sector providers will now also fall under the states purview, in addition to the centre. With our FY17/18 real GDP forecast at 7.3%, growth could moderate by 20-60bps, estimating from the post-VAT impact and global references.

b) Cross-country studies tend to show inflation rising immediately after the GST rollout but dissipating thereafter. In India's case, there are fewer concerns as most essential goods and services have been exempted. The tax incidence is likely to rise mainly on selected service sector categories.

The GST is meant to be revenue-neutral but some gains will accrue with a lag. Hence, centre and state deficits (upside risks because of the farm loan waivers) are likely to remain around 3.0-3.5% of GDP this year. Going into the post-GST nuances, states have been assured compensation for five years if revenue growth falls below 14%. This is slightly faster than the current run-rate, suggesting states' books will benefit in the first few years. There will, nonetheless, be inter-state variations, depending on existing revenue streams (states heavily reliant on petroleum and alcohol sales for bulk of revenues will benefit as these items fall outside the GST purview).

c) According to the RBI, most cesses and surcharges that used to accrue only to the centre will now be pooled into the divisible fund. In all, a study of pre and post GST breakdown of revenue sub-heads suggests that the states' share might rise from the present 42:58 share of the pool. Longer-out, this move to consolidate the tax structure is expected to help boost India's tax to GDP ratio, which currently lags most emerging economies.

d) Apart from the economic impact, intangible benefits are significant. These will be again more apparent further afield, as the complexity of the new GST structure lowers efficiency gains in the near-term.

Over the next two-three years, key improvements will include a simplified and transparent tax structure, better tax compliance, formalisation of the economy, greater competitiveness and lower inefficiencies due to cascading taxes. This will address one of the sticking points for domestic and foreign investors, also raising India's rank in the World Bank ease of doing business matrix, where it currently lags. These measures, cumulatively, will be important for the government's 'Make in India' initiative and plans to expand the manufacturing base.

GDP Growth rate Estimate by IMF											
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
GDP growth Rate	6.64	5.62	6.64	7.24	7.56	7.62	7.61	7.67	7.83	7.96	8.12

Source- International Monetary Fund

In sum

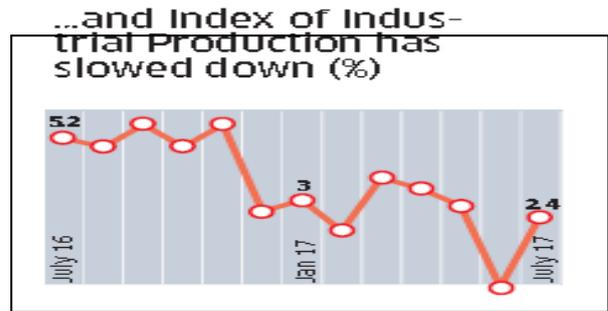
Notes: [1] Domestically, a study conducted by the National Council of Applied Economic Research, commissioned by the Thirteenth Finance Commission pegged the long-term boost to GDP growth at 0.9-1.7% (http://www.ncaer.org/news_details.php?nID=73). - A 2015 GST report - Report on the Revenue Neutral Rate and Structure of Rates for the GST- pegged the boost to growth by an incremental rate of 0.5%.

Pre GST Fears- Destocking

Indian economy is classified in three sectors — Agriculture and allied, Industry and Services. Agriculture sector includes Agriculture (Agriculture proper & Livestock), Forestry & Logging, Fishing and related activities. Industry includes 'Mining & quarrying', Manufacturing (Registered & Unregistered), Electricity, Gas, Water supply, and Construction. Services sector includes 'Trade, hotels, transport, communication and services related to broadcasting', 'Financial, real estate & prof servs', 'Public Administration, defence and other services'. Services sector is the largest sector of India.

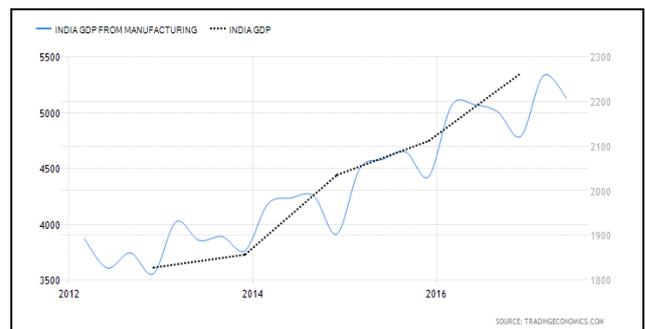
India's gross domestic product data shocked again on Wednesday as economic growth unexpectedly slumped to its lowest in more than two years in the March quarter, stripping the country of its status as the world's fastest growing major economy.

EX- Maruti paid dealers a one-time compensation for the transition to GST and also higher discounts to clear dealer inventory which hurt margins; gross margins fell 40 basis points y-o-y. While a stronger economy may have helped offset the impact of the GST rollout, it is evident demand remains sluggish. Ashok Leyland, for example, saw its profit before tax crash 52% y-o-y as volumes remained weak. Bajaj Auto's revenues slipped 5% y-o-y as volumes fell 10.7%; the lower channel inventory and a postponement of purchases by customers due to GST impacted wholesale numbers. Net operating revenues at Asian Paints were up just 6% y-o-y with volumes growing at around 2-3%, partially the effect of pre-GST de-stocking. At Nestle, too, net sales rose 7% y-o-y, well below estimates, and again the result of retailers picking up less stock.



Source- The Economics Times

Annual economic growth at 6.1 percent in the January-March period was even lower than the lowest analyst estimate of 6.5 percent in a Reuters poll. Overall, the median forecast of 36 analysts was for a year-on-year growth of 7.1 percent.



Source- Central Statistical Office

Demonetisation had no role in fall of GDP. Instead, active de-stocking in anticipation of GST (goods and services tax), higher base and a deflationary impact of WPI (wholesale price inflation) had led to a fall in economic growth,” Kumar said. India's GDP growth slumped to a three-year low of 5.7% in April-June against 6.1% in the preceding quarter and 7.9% a year ago, the slowest pace since the January-March quarter in 2014. “Every country undertaking fundamental governance reforms has seen a dip in economic growth,” Kumar said.

FORECASTING THE GDP GROWTH

According to him, Niti Aayog should have its own forecasting unit instead of relying on estimates from the International Monetary Fund. However, Kumar was quick to add that the situation would improve from the next quarter. "I am confident that with a good monsoon, increase in FDI and FIIs, smooth rollout of GST and a large number of IPOs lined up, economic growth in the July-September quarter will be in the range of 7-7.5%,"

- There is a mix impact of demonetisation and De stocking due to pre GST fears on GDP growth. The issue is a genuine demand-side problem created by external markets to a large extent and dim investments.- Pronab Sen, Former chief statistician
- Twin factors – de-stocking before the goods and services tax (GST) implementation and rise in whole sale inflation of inputs pulled down economic growth during the first quarter of FY18. – T C A Anant, chief Statistician
- The First quarter GDP growth touched the lowest in 13 quarters at 5.7 per cent. Anant did not think that demonetisation should be linked to the slowdown in growth. De-accumulation of stocks by companies and traders in anticipation of GST , which was implemented from July 2017, explained the poor growth in the manufacturing sector, at 1.2 per cent compared to a robust 10.1 per cent in the corresponding quarter of last year. The major reason for growth coming in 5.7 per cent is manufacturing, where the performance of corporate sector has been poor. Even though top line sales growth is quite good, there are two elements to low GVA- rise in cost and destocking ahead of GST roll out.
- Corporate entities pulled down stocks and inventories on account of a price labelling effect. Sales were up positively reflecting in the trade segment , but production was down pulling down manufacturing “ inventories de-accumulation of this level was seen for the first time.”
- Anant however expected a revival in inventory stock position in the second quarter of the

fiscal year. It may be reversal effect in subsequent 2-3 quarter.

- The economic survey has forecast growth of 6.75 per cent to 7.5 per cent.
- Agriculture GVA grew 2.3 per cent in Q1 versus 2.5 per cent last year. Financial, insurance, real estate and professional services grew 6.4 per cent. The financial services sector performed well but real estate pulled down.

GDP at constant (2011-12) prices in Q1 of 2017-18 is estimated at ` 31.10 lakh crore, as against ` 29.42 lakh crore in Q1 of 2016-17, showing a growth rate of 5.7 percent. Quarterly GVA at basic price at constant (2011-2012) prices for Q1 of 2017-18 is estimated at ` 29.04 lakh crore, as against `27.51 lakh crore in Q1 of 2016-17, showing a growth rate of 5.6 percent over the corresponding quarter of previous year.

4. The economic activities which registered growth of over 7 percent in Q1 of 2017-18 over Q1 of 2016-17 are ‘trade, hotels, transport & communication and services related to broadcasting’, ‘public administration, defence and other services’ and ‘electricity, gas, water supply & other utility services’. The growth in the ‘agriculture, forestry and fishing’, ‘mining and quarrying’, ‘manufacturing’, ‘construction’ and financial, insurance, real estate and professional services is estimated to be 2.3 per cent, (-) 0.7 percent, 1.2 per cent, 2.0 percent and 6.4 percent respectively during this period.

‘Economy will Expand at 7-7.5% in Q2’

- National Council of Applied Economic Research (NCAER) pegs FY'18 GDP growth at 7.6% on normal monsoon
- The World Bank has forecast growth to be 7.2 per cent during 2017-18.
- On the global front, the IMF estimates that the unified indirect tax could raise medium-term growth to over 8% (2017 Article IV Consultation; Feb17)

A US Federal Reserve study forecasts a rise of 3.1-4.2% in growth - “The Effect of the GST on Indian Growth”; Mar17

VI- CONCLUSION

It was found that the variable which affects the growth of GDP components (Manufacturing, Service, Industry) In this study, the impact of GST on GDP components had been analysed. But it was found that GDP growth has been declined drastically to 5.7 per cent instead of forecasted 7 per cent. After the detailed study it was observed that GDP growth rate was hit for short term. Due to fear factor of implementation new indirect tax reform. Many international reports forecasted that the figure 5.7 is only for short term , in medium and long term GST will help the growth of GDP may be 7-7.5 percent. Despite of slowdown in the GDP growth rate to 6.1 per cent in the fourth quarter to March 2017, and 5.7 per cent in Q1 of FY18, the top economist of the country are hailing optimism. India's Double Digit Growth - Is 10% GDP Growth A Wishful Thinking. This question may lead to further study on this topic. Implementation of the GST system will be a litmus test for the government's ongoing reform agenda ahead of the 2019 general elections. Despite initial teething issues, we expect the negative impact to even out over the course of the year. Tangible and intangible benefits from the GST regime should boost the economy's growth and rating prospects.

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