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# From Fragmentation to Unity: GST's Influence on the Indian Economy

**Pal Jeetendra[1], Singh Vivek Kumar[2]**

[1]Research Scholar, Deptt. of Economics, Armapore P G College, Kanpur
[2]Asst. Professor, Deptt. of Economics, Armapore P G College, Kanpur

**Abstract-**
The complexity of doing business in India was high due to multiple overlapping taxes. The introduction of GST streamlined this by establishing a unified, transparent tax system. GST has fundamentally transformed India's indirect tax framework, consolidating most taxes on goods and services—covering traders, manufacturers, and the sale and consumption activities—into a single tax. As one of the most significant tax reforms in India, GST replaced various indirect taxes, including Excise, Central Sales Tax, VAT, and Service Tax, which previously caused a cascading effect on pricing. This study explores GST's impacts across different sectors of the Indian economy, revealing both positive and negative outcomes based on industry characteristics and prior tax rates. Notably, GST has shown beneficial effects in sectors such as manufacturing, FMCG, and IT.

**Keywords:** Banking; entertainment; fast-moving consumer goods; indirect taxes; logistics; manufacturing; taxation system.

## INTRODUCTION

The Goods and Services Tax (GST) is the most substantial reform in India's indirect tax system since independence, combining multiple taxes into a single, unified rate on a wide range of goods and services. Introduced on July 1, 2017, GST represents a crucial move towards strengthening India's economic growth. Previously, conducting business in India was complex due to overlapping taxes, but GST has simplified this by establishing a transparent and structured tax system. It has reshaped the indirect tax landscape by consolidating taxes that apply to traders, manufacturers, and the sale and consumption of goods and services into a single tax framework. This transformation is one of the most significant in India's taxation history, eliminating nearly all previous indirect taxes like Excise, Central Sales Tax, VAT, and Service Tax, which previously led to compounding tax effects on prices.

The GST system replaces a range of prior taxes with a single-point tax, particularly benefiting sectors like fast-moving consumer goods (FMCG) by reducing tax layers on frequently purchased items. Previously, taxes such as VAT, Service Tax, Excise Duty, and Central Sales Tax created a fragmented and burdensome structure.

Now, GST integrates all indirect taxes at both state and central levels, facilitating a more seamless national market. It is anticipated that GST will not only reduce the tax load of the prior system but also contribute significantly to India's GDP growth. As a consumption tax applied to the supply of goods and services, GST aims to unify India under one tax regime, eliminating the issues of double taxation and tax cascading, in a comprehensive effort led by the Indian government.

The Indian government introduced GST to transition the economy towards a destination-based consumption tax model. By consolidating various taxes, including central excise duty, service tax, entertainment tax, VAT, central sales tax, luxury tax, and additional state surcharges on goods and services, GST has marked a substantial shift in India's indirect taxation. This reform, which merges numerous central and state levies into a single tax, alleviates issues of double taxation and facilitates a unified national market. For consumers, a major benefit is the reduction in the overall tax rate on goods and services. GST also enhances the competitiveness of Indian products domestically and internationally. With its streamlined structure, GST simplifies administration, holding promise for the continued economic progress of India.

GST functions as an indirect tax that supersedes multiple prior taxes nationwide. Enacted on March 29, 2017, and implemented on July 1, 2017, the GST Act establishes a comprehensive, multi-stage tax system levied on goods and services at each point of value addition from production to consumption. Input tax credits at each stage minimize the effective tax burden, so the end consumer only pays GST on the final purchase. Studies indicate that the clarity and transparency offered by GST provide a more efficient tax system compared to the previous VAT structure.

**A Reformative Journey of GST in India-**

India's path to implementing GST began in 2000 when a committee was formed to draft the legislation. After 17 years of deliberation, the GST Bill was finally passed by both the Lok Sabha and Rajya Sabha in 2017, with the GST law officially taking effect on July 1 of the same year.

**The Economic Significance of GST in India-**

GST represents one of the most significant tax reforms in India, aimed at unifying the state-level financial systems and enhancing the nation's overall economic performance. It is a comprehensive indirect tax levied on the production, distribution, and supply of goods and services across the country, replacing various previous indirect taxes imposed by both central and state governments. Implemented on July 1, 2017, GST follows a destination-based model, meaning that tax is collected by the state where goods or services are consumed. India has adopted a dual GST structure, where both the central and state governments levy taxes on goods and services, effectively merging multiple taxes at both levels into one integrated system. This approach aligns with global practices, as over 160 countries worldwide have implemented similar GST frameworks.

**The Rationale Behind GST Implementation in India-**

The introduction of GST in India was motivated by the need to simplify a complex and fragmented tax structure. Previously, the Central Government imposed taxes on manufacturing (Central Excise), services (Service Tax), and interstate trade (CST), while State Governments applied VAT on sales, Entry Tax on goods brought into the state, Luxury Tax, and Purchase Tax, among others. This created a maze of overlapping taxes along the supply chain, with no provision for setting off central taxes against state taxes, leading to compounded costs. Additionally, varying VAT laws, tax rates, and practices across states divided the country into separate economic zones, further hindered by Octroi, Entry Tax, and numerous checkpoints, all of which disrupted the free flow of trade across India.

The high compliance burden from managing multiple taxes and filing numerous returns also added to taxpayer costs. GST addresses these issues by merging central and state taxes into a unified system, significantly reducing overlapping tax collection, multiple tax points, and compliance costs. By establishing a uniform tax rate nationwide, GST ensures consistent tax application across states, with the central and state governments sharing revenue collection. The primary objective of GST is to create a single tax framework that applies to both the production and sale of goods and services at both central and state levels. This reform effectively replaces prior taxes like VAT, Excise Duty, and Sales Tax, simplifying tax payments for consumers, who now pay only one consolidated tax on goods and services under GST.

**Components of GST-**

SGST (State Goods and Services Tax) is levied and collected by the state government. CGST (Central Goods and Services Tax) is imposed and gathered by the central government. IGST (Integrated Goods and Services Tax) is administered and collected by the central government.

**Understanding the GST Framework**

GST is a unified tax applied to the supply of goods and services throughout the production and distribution process, from manufacturer to consumer. At each stage of value addition, input tax credits for previously paid taxes are available, making GST effectively a tax only on the added value at each stage. This ensures that the final consumer pays only the GST charged by the last seller in the supply chain, with credits offsetting previous tax layers.

In most countries with GST, a single unified system is used, applying a consistent tax rate across the nation. Such systems merge central taxes (like sales, excise, and service taxes) with state taxes (such as entertainment, entry, transfer, and luxury taxes) into one comprehensive tax. Given India's federal structure, GST operates through two components: Central GST (CGST) and State GST (SGST). Both the central and state governments collect GST throughout the value chain, with CGST collected by the center and SGST by the states for transactions within a state.

Under this system, CGST credits can be used to offset CGST liabilities, while SGST credits apply to SGST liabilities, preventing any cross-utilization of credits between central and state taxes. CGST and SGST are levied together on each transaction, except for exempt goods and services, items outside GST's scope, and transactions below specified thresholds. Unlike the previous VAT system, which included central excise in the taxable value, GST applies uniformly to the actual cost or value of goods and services.

For interstate transactions, the Central Government collects Integrated Goods and Services Tax (IGST) on all supplies of goods and services between states, as provided by Article 269A (1) of the Constitution. The IGST rate generally equals the sum of CGST and SGST rates. The IGST framework is designed to ensure seamless input tax credit transfers between states. In interstate sales, the seller pays IGST to the central government after offsetting credits for IGST, CGST, and SGST on their purchases. The state exporting the goods transfers the SGST credit to the center, while the importing state receives IGST credit from the center, allowing the buyer to offset this against their CGST and SGST liabilities. As GST is destination-based, the SGST collected on the final product ultimately benefits the consuming state.

**Impact of GST Across Different Sectors**

**Pharmaceutical Sector:**

The Goods and Services Tax (GST) has had a significant impact on the Indian pharmaceutical industry, notably increasing manufacturing costs. Previously, many drugs were taxed at 4% under the VAT system but now fall under the 5% GST bracket. GST aims to eliminate the cascading effect of multiple taxes on a single product. However, Ayurvedic medicines are now taxed at 12%, up from the previous

4% under VAT, leading to a necessary revision of the Maximum Retail Price (MRP) to adjust to the increased tax burden.

Despite these challenges, GST also brings positive changes. The traditional cost and distribution model is shifting toward more efficient supply chains due to the removal of the Central Sales Tax (CST), making interstate transactions between dealers tax-neutral. Pharmaceutical companies are likely to benefit from enhanced operational efficiency and compliance improvements. The new tax structure also optimizes warehousing strategies. Previously, companies established warehouses in various states to avoid differing state CSTs; with GST, they can consolidate these warehouses at strategic locations, only paying Integrated GST (IGST) on interstate supplies. Ultimately, GST has simplified the tax landscape for the pharma sector by merging multiple taxes into a single rate and reducing overall complexity.

Pharmaceutical manufacturers producing generic or branded formulations and dietary supplements, who previously faced high excise duties, are set to benefit from reduced taxation and lower operational costs across the industry. GST on bulk drugs tops out at 18%, while the highest rates for formulations are capped at 5% and 12%. As a result, formulators will bear higher taxes under GST but face reduced charges on formulations, leading to accumulated input tax credits that will be automatically refunded.

Pharmaceutical companies and business owners will also gain greater freedom to optimize their supply chain and distribution strategies with fewer restrictions. The concept of CENVAT credit—used as a credit balance that could be refunded or offset against excise duty on purchases or final products—is effectively resolved in the pharmaceutical sector due to GST's uniform rate for both goods and services.

Despite its advantages, GST has introduced some challenges for the pharmaceutical sector: Many Ayurvedic products now fall under a 12% to 15% tax category, as many of these items are classified as cosmetics. GST has increased the indirect tax burden on pharmaceutical companies by 60% and raised MRP by 4%, with tax rates reaching 15% and as high as 18% for diagnostics and reagents. Additionally, various pharmaceutical drugs, medicines, and medical technology products are now taxed at either 5% or 12%, compared to a pre-GST combined tax rate (including VAT) of around 11.5% to 12.5%, which has increased to up to 18% under GST.

**IT/ ITes Sector:**

Under GST, many IT industry essentials such as printers, ink cartridges, photocopiers, and fax machines are now taxed at 28%, up from the previous 18%. Although this hike has raised costs, the IT sector has still seen growth. Service tax in the IT industry also rose from 15% to 18% under GST, increasing implementation costs. However, the availability of input tax credit (ITC), which was not permitted under VAT, now provides a notable advantage.

One significant adjustment for IT businesses, particularly ERP and accounting service providers, is the need to update their systems to be GST-compliant or to develop entirely new GST software, such as Gen GST, which has raised operational costs. Previously, the IT sector was subject to a single point of tax collection under the central service tax. Now, the GST system requires companies to coordinate with both state and central authorities, increasing compliance costs due to 111 points of tax collection.

GST has removed the cascading effect on IT products and services, meaning consumers now pay only the actual tax amount, which reduces overall costs and enhances the investment potential of IT firms. Additionally, exports of IT services like software development, consultancy, and BPO are zero-rated under GST, allowing companies to claim credits on input taxes paid, further supporting the sector's growth.

**Automobile Sector:**

The automobile sector has benefited positively from the implementation of GST, primarily due to lower tax rates for manufacturers, which ultimately translates to savings for consumers. Previously, the combined tax burden on vehicles, including excise duty and VAT, ranged from 26.5% to 44%. In contrast, the standard GST rates are set at 18% and 28%, significantly reducing the tax burden on end consumers.

Furthermore, the elimination of Central Sales Tax (CST) means that companies no longer need to maintain multiple warehouses or rely on clearing and forwarding agents across various states. This consolidation allows them to optimize their warehousing infrastructure, thereby reducing operating costs within the supply chain (Sharma & Sharma, 2018). Additionally, GST removes the cascading tax effect, allowing manufacturers to offset all taxes paid on inputs against their output GST liability, leading to lower overall manufacturing costs for vehicles.

**Logistics Industry:**

Logistics plays a vital role in supporting manufacturing and operational activities essential for economic growth, especially in a rapidly developing country like India, where demand is consistently high. GST, recognized as India's most transformative tax reform, is expected to significantly impact all sectors, with the logistics industry being one of the most positively affected. Since GST's implementation, India has improved its logistics performance ranking, moving up 19 positions from 54th to 35th place. The introduction of the E-Way bill has further streamlined the clearance process and reduced corruption.

If effectively implemented, GST will deliver dual benefits to the logistics sector: it will lower logistics costs and increase efficiency for both domestic and international trade. This aligns with the primary objective of logistics management—to ensure customer satisfaction at minimal costs (Indhumathi & Suresh, 2017). Additionally, GST is expected to promote the growth of organized service providers, as logistics companies no longer need to factor in multiple state taxes. Currently, the logistics industry remains highly fragmented, with only a few large, organized players, but GST may lead to a more consolidated and structured sector.

**Banking Sector**

The introduction of GST has impacted banking operations, transactions, accounting, and compliance requirements, necessitating a comprehensive overhaul. While GST aims to streamline the tax system and eliminate inefficiencies inherent in the previous complex structure, there are still ongoing discussions about threshold limits, tax rates, and the inclusion of items like crude oil, electricity, liquor, and real estate (Sagayaraj & Akalya, 2019).

The effects of GST on the banking sector are complex. One significant change is the increase in the GST rate for banking services—such as ATM and insurance services—from 15% to 18%. Additionally, processes like adjudication, assessment, and claiming input tax credits have become more cumbersome, adding to the sector's compliance burden. Transaction fees for services, including credit card payments, fund transfers, ATM transactions, and loan processing fees, are also now subject to 18% GST. Banks face additional challenges with state-specific registration requirements, determining the place of supply, the taxability of interest, and reversal of input tax credits on capital goods. Overall, GST has imposed additional complexities and costs on the banking sector, resulting in a generally negative impact.

**Entertainment Industry:**

India's media and entertainment industry is rapidly expanding and ranks among the largest globally

(Kumar & Krishnan, 2020). GST's impact on this sector has been mixed, with varying effects across states. In states where no entertainment tax was previously levied to encourage local films, GST has added a tax burden. However, states with high pre-GST entertainment tax rates now benefit from reduced rates. The standardized GST rates of 18% to 28% have positively impacted multiplex operators, likely increasing their profitability by replacing widely differing pre-GST rates, which ranged from 0% to 110% in different states.

In states where prior tax rates were below 28%, GST has increased costs, but in states where rates exceeded 30%, it has reduced the burden. Additionally, GST has lowered costs for Direct-to-Home (DTH), cable services, and print media advertising, benefiting consumers as demand for these services has grown (Kumar & Krishnan, 2020). Entertainment service providers can also claim input tax credits (ITC) under GST, contributing to the sector's overall positive response to this reform.

**Textile Sector:**

The textile industry has faced negative impacts from GST. Previously exempt from taxes, the sector now falls under a 5% GST rate, which has increased clothing prices. Additionally, GST has had a detrimental effect on textile exports. The excise duty on cotton fabrics rose from 5% to 6%, while duties on synthetic inputs like polyester and viscose went up to 12%. The abatement for branded ready-made garments also increased, from 55% to 70% of the retail price (Borate & Ghorpade, 2019). The GST implementation has caused confusion among small traders in the textile industry.

Despite these challenges, GST has addressed revenue leakages present in the previous tax system, reduced the overall tax burden, eliminated cascading effects, and enabled a smoother input credit flow for most commodities. According to Chakraborty (2018), these reforms, which offer benefits beyond the former VAT system, are anticipated to foster India's economic development, with potential long-term positive effects trickling down to the textile sector as well.

**FMCG Industry (Fast-Moving Consumer Goods)**

Beyond simplifying compliance, GST has significantly impacted the FMCG sector, particularly with respect to tax rates. Previously, industry players faced combined tax rates of approximately 27%, including an excise duty of 12.5% and VAT ranging from 12% to 15%. The GST regime introduced rates between 5% and 28%, providing substantial benefits to the sector. This shift affects pricing, working capital, merchant and client contracts, ERP systems, processes, internal controls, and accounting.

One notable benefit of GST for FMCG companies is the opportunity to optimize their supply chains based on business needs rather than tax considerations (Kumar & Kumar, 2017). Overall, the FMCG sector has responded positively to GST. As the largest economic platform in India, FMCG products under GST are generally taxed at rates between 18% and 20%, offering direct benefits to consumers through reduced costs.

**Conclusion:**

GST fosters a business-friendly environment by applying a uniform tax rate that is expected to gradually lower price levels and inflation. This transparency strengthens government finances by making tax evasion more difficult (Shaik et al., 2015). The primary purpose of GST is to uplift economically disadvantaged populations and stimulate business activities. GST is imposed at every supply point, providing a straightforward, corruption-resistant tax structure that removes the flaws of the previous system. It benefits both businesses and consumers, aiming to create a unified national market by eliminating fiscal barriers between states, which enhances tax compliance (Manoj, 2019).

GST also improves India's positioning in global trade negotiations and broadens the tax base by bringing SMEs and informal sectors into the formal tax system. It provides producers and consumers relief through comprehensive input and service tax credits, and by merging multiple taxes, it generates resource and revenue gains for both the central and state governments through expanded compliance (Khurana & Sharma, 2016; Lourdunathan & Xavier, 2017). GST is expected to improve tax collections, boost India's economic growth, and eliminate barriers between central and state taxation (Nayyar & Singh, 2018). Although it introduces new paperwork, especially for smaller companies needing to adapt, GST promotes a more stable Indian market, enhancing competitiveness with foreign companies.

The positive impacts of GST extend across various sectors, including manufacturing, employment, FMCG, and IT, creating commercial benefits, increased employment, and contributing to economic growth that will ultimately raise the country's GDP (Nath, 2017).

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