

Why states hold the key to make the GST 2.0 reform a big success

They have the capacity to increase their tax revenues. A small investment today could lead to a wider tax base tomorrow



PRACHI MISHRA & SHOHAN MUKHERJEE

are, respectively, dean of Ashoka School of Economics, director and head of Ashoka Isaac Centre for Public Policy (ICPP), and professor of economics at Ashoka University; and research associate, Observer Research Foundation.

Nine years after its launch, India's goods and services tax (GST) has been rewired. GST 2.0, which took effect on 22 September 2025, collapsed the four-slab structure for consumer goods (5%, 12%, 18% and 28%) into two main rates of 5% and 18%. Special rates of 0.25% and 3% remain, and a new 40% rate applies to a few items. Of the 506 goods covered by the GST Council's recommendations, about 90% saw their rates cut.

Our estimates suggest the effective GST rate has fallen only from 11.64% to 11.30%, a modest sacrifice that follows a familiar logic: lower rates can over time increase collections by widening compliance and stimulating activity. While most of the debate has centred on revenue implications, the more important question is how the transition is managed and by whom. The answer, we argue, is India's states.

How quickly the reform pays for itself depends on two things: whether businesses pass rate cuts on to consumers and how responsive demand is to lower prices. Early evidence is mixed, but the longer view is more encouraging. As effective rates have come down since 2017-18, gross GST revenue as a share of gross domestic product (GDP) has held up. The same is true of its state and inter-state components, apart from the pandemic dip in 2020-21.

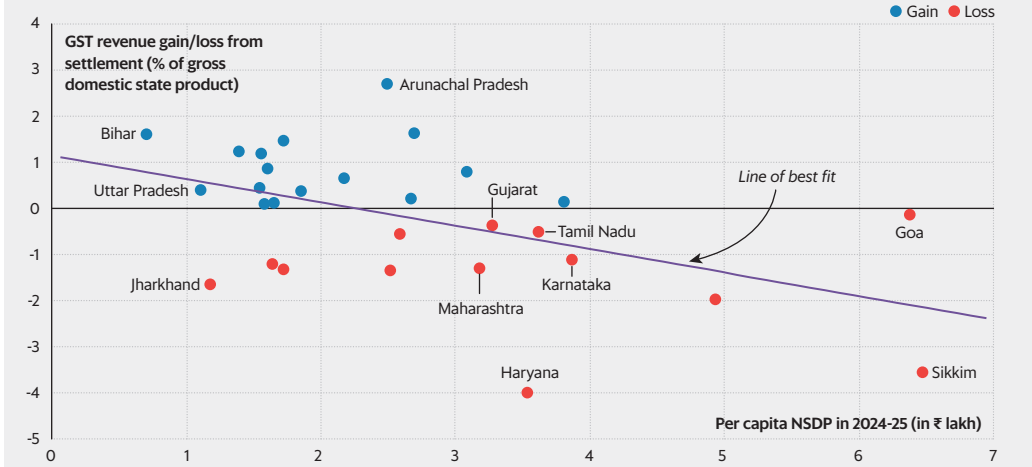
The more telling story lies beneath the national totals. State GST collections have two parts: state GST (SGST), retained by the state where a transaction takes place, and integrated GST (IGST), levied on inter-state sales and collected by the Centre, which then passes on the destination state's share. If a Maharashtra manufacturer sells furniture to a Karnataka retailer, it charges IGST, and Karnataka receives its share because that is where the furniture is retailed for consumer use.

Before this settlement, the gaps between states are stark. Haryana collects SGST and IGST equivalent to about 7.7% of its state GDP; Bihar collects about 1.3%, a sixfold difference under the same tax code. Much of it reflects the size of the industrial and services base. After settlement, the gap narrows sharply: Haryana falls to around 3.4% and Bihar rises to about 2.9%. This is not a negotiated transfer. It is built into the destination-based design, a structural form of cooperative federalism that moves resources from where goods are made to where they are consumed.

The stakes for state budgets are high. Roughly half of Indian states' own tax revenue comes from GST. Collection performance largely determines

GST revenue: Rebalancing act

Gaps between various states/UTs are wide before settlement transfers to those where goods and services are finally sold.



NSDL: Net domestic state product
Source: RBI Handbook of Statistics on Indian States, GST Statistics
mint
PRATEEK KUMAR/MINT



how much room a state has for capital spending, which tends to have the largest growth multiplier. States that pair strong collection with well-targeted spending are best placed to grow faster and contribute to the Viksit Bharat goal of a high-income, developed economy.

So, how can states raise more? Three steps can be taken, all of which are within their own control.

The first is to know the tax base better. Measurement is the starting point, and it is good news that states already hold rich data. Also, the digitization of GST makes it easier to map the informal and under-registered economy against potential collections. Maharashtra built a data warehouse on GST Network data that risk-profiles its entire taxpayer base, with parameters refined every year. Karnataka worked with IIT Hyderabad to bring

registrations, returns and e-way bills into a single analytics portal. Earlier analytics work there produced a 15-fold rise in the detection of bogus entities, blocked about ₹278 crore of fraudulent input tax credit claims and flagged fake turnover of around ₹4,250 crore. Neither state needed new legislation or a rate change, and both drew on partners, from Capgemini and PwC to IIT Hyderabad. States need not build this capability alone.

The second is to make compliance easier. Compliance rises when the benefits of registering and reporting honestly outweigh the costs, and those costs are mostly administrative: the time spent filing, reconciling invoices and resolving disputes. Simpler processes, faster refunds and clearer rules help. So does smarter enforcement. Andhra Pradesh uses artificial intelligence (AI) and machine learning, with a 35-parameter risk matrix, to score taxpayers and select cases for scrutiny. Directing attention to higher-risk cases spares compliant businesses needless checks and makes enforcement more credible. The aim is to make honest compliance the simplest and most predictable choice.

The third is to re-use the data. States investing in granular GST taxpayer and transaction databases need not limit them to GST. Excise on alcohol, stamp duty and registration fees, vehicle taxes, electricity duties and land revenue together account for roughly 25-35% of states' own tax revenue. Yet, weak taxpayer identification has left much of this revenue uncollected. Cross-referencing these against an existing GST information system is a high-return, low-cost way to unlock more from an asset already built.

The end of GST compensation also removes a distortion in incentives. When states were compensated for revenue shortfalls, the marginal return to improving tax collection was weaker. Every additional rupee collected could reduce the compensation received. With compensation now ended, every rupee gained through better tax administration directly strengthens state finances.

The short-term cost of GST 2.0 is small, and it is the price of a system designed to expand over time rather than extract more today. The path to stronger state finances may run not through higher rates, but through a wider base and deeper voluntary compliance, both squarely within states' own capacity to deliver on.

Ashutosh Dikshit, Vijay Singh Chauhan and the ICPP team contributed to this article.