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What the proposed GST hike on sin goods means for businesses and jobs



BY

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There is an indication that a new goods and services tax (GST) slab will be introduced, in addition to the existing four GST rates: 5%, 12%, 18%, and 28%. The Group of Ministers (GoM) in the [GST council has proposed](#) increasing the tax rates for tobacco and related products, as well as aerated beverages, to 35%. There are also suggestions to increase the GST on [luxury items](#), such as shoes costing above Rs 15,000 and wristwatches priced above Rs 25,000, which are likely to be shifted to the highest slab of 28% GST from the current 18%. Additionally, cotton and textile items may be moved from their existing tax slabs to the next highest GST slab rates.

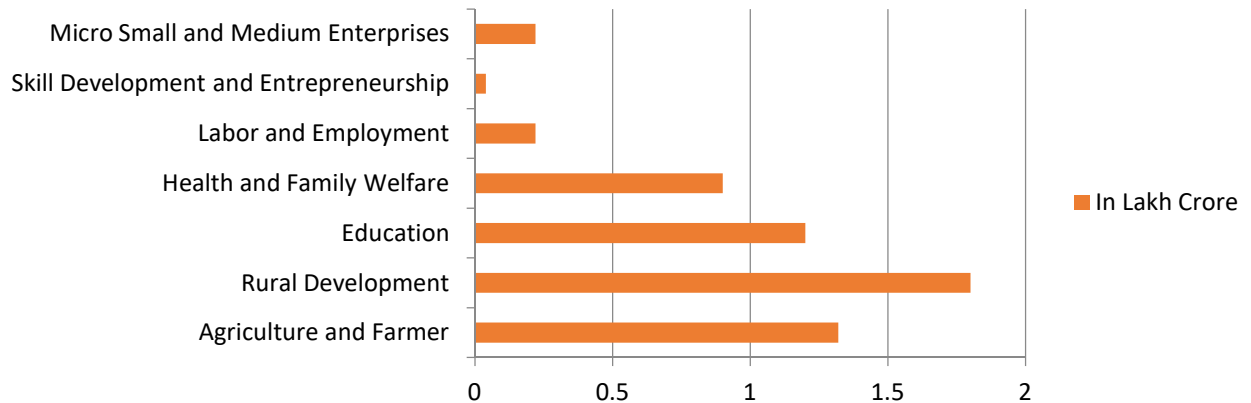
Why is there such an urgency to introduce an additional GST slab, especially on the higher side, which could complicate the indirect tax structure? Many developed countries, such as Australia, Canada, New Zealand, and Japan, have a single GST rate, typically ranging between 5% and 15%. A higher multi-layered GST slabs could have the unintended consequence of dampening consumption and negatively impacting businesses. With GST collections already at record levels, exceeding Rs [20 lakh crore](#) in 2023-2024, there is no urgent need to introduce an additional 35% tax slab, particularly when India's economy is already grappling with challenges like a slowing growth rate [of 5.4%](#).

Apparently, for the government, the need to collect taxes stems from the goal of facilitating income transfers, which play a crucial role in securing votes. The tax on sin goods is price inelastic, meaning that consumers (who are otherwise addicted to the habit) will continue to consume them. The government may believe that increasing the tax will simply boost the tax revenue. This may be the government's way of transferring resources from the middle and upper-middle class to finance election promises, such as the *Ladli Behna Yojana*, *Kanyashree Prakalpa*, or other schemes aimed at the marginal voters. As per a recent estimate [Rs 2 lakh crore annualised](#) worth of income transfers happening. These are benefiting 20% of India's adult women and all in the very low-income segments. Although cash transfers may initially appear to be a good solution for supporting low-income households, they can hinder the long-term development of the economy.

One of the primary reasons voters often favor short-term freebies over long-term subsidies is the human tendency toward temporal discounting. Temporal discounting is the psychological phenomenon where people tend to undervalue rewards or benefits that further in the future, prefer immediate gratification instead. Politicians are acutely aware of voters' preferences for short-term gains. To secure re-election, the political elites prefer to implement populist policies, even if these policies may not be sustainable in the long run.

Over-reliance on freebies can cause fiscal imbalances, leading to large deficits, inflation, and long-term economic instability. Neglecting productive investment for long-term growth, such as in education, technology, and infrastructure, can lead to stagnation, reduced global competitiveness, and lower quality of life. Rs 2 lakh crore spent on income transfers exceeds the funds allocated in the Union Budget 2024-2025 on account for Micro Small and Medium Enterprises (MSME), agriculture, education, health, and skill development.

Budgetary Allocation, Union Budget (2024-2025)



Source: Ministry of Finance (<https://www.indiabudget.gov.in/>)

At a time when employment opportunities are scarce, economic logic suggests that more funds should be allocated for the MSMEs, education, and skill development. According to the Periodic [Labour Force Survey Annual Report](#) 2022-23, the majority of jobs are being created in the low-paying agricultural sector and in the category of self-employment in the urban sector. This has an implication on widening income inequality.

The increase in GST rates on carbonated soft drinks (CSD) and tobacco products affects people from all sections of society, as these items are widely consumed. Low and middle-income households are likely to be hit harder, as higher taxes will strain their budgets more. The government's justification for curbing consumption—and thereby promoting greater health benefits—through higher taxes on certain products is illogical, given that it continues to impose a high GST on health insurance.

A higher and a more complex GST structure can have other repercussion. First, an increase in the GST slab to the next highest level may [lead up to 8%](#) rise in the price of readymade garments, making our exports uncompetitive in the global market. Second, when accounting for the Cess on items such as tobacco, automobiles, and carbonated soft drinks, the total tax could reach 50%, with a negative impact on businesses and government losing out on revenue. As suggested by the [Laffer Curve](#) principle, excessively high tax rates can dampen consumption and lead to a shift towards lower-taxed substitutes or even illicit tobacco and soft drink products, ultimately reducing tax revenue collection.

Third, higher tax structure can also act as an “industry killer” take for example the case of gaming and crypto currency. The hike in GST rate from 18% to 28% on the gaming industry has seen the business moving out to Singapore. Gaming differs from lotteries, gambling, and betting in that its outcome depends on the skills of the players, rather than chance. Similar is the case with crypto currency with most of the businesses moving out to Dubai and Hong Kong. According to [NASSCOM](#) the Indian cryptocurrency market has been growing exponentially over the last few years and is expected to reach up to \$241 million by 2030 in

India and \$2.3 billion by 2026 globally. The government is not only losing out on the revenues generated by these businesses but also on both direct and indirect employment opportunities.

Finally, there is also evidence suggesting that cash transfer/freebies are reducing allocations to other more essential areas, such as health and education. For example, while the Government of West Bengal is running the hugely popular *Kanyashree* project for girls, it has led to [lower allocations](#) for building primary school infrastructure and hiring school teachers.

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