Lower Taxes, Higher Trust

GST rationalisation is quietly reshaping India's fiscal philosophy, from taxing more to trusting more.

Representational Image iStock.com

By Nilanjan Banik

Nilanjan Banik is a Professor at the School of Management, Mahindra University, specialising in trade, market structure, and development economics.

October 25, 2025 at 5:54 PM IST

India's latest GST rationalisation has quietly reopened an old question in fiscal economics: can lower taxes really yield higher revenues? At least, this was the undercurrent last week, when I found myself in a room full of GST and Customs commissioners, officials who live and breathe tax codes and compliance metrics.

The September GST collection of ₹1.89 trillion, up from ₹1.86 trillion in August despite rate cuts on dozens of items, suggests that it can. The evidence fits neatly with the Laffer Curve intuition, that there exists an optimal tax rate which maximises revenue without discouraging spending or enterprise.

Yet, the deeper story lies beyond Arthur Laffer's famous napkin sketch.

It lies in how a maturing Indian state is beginning to trust its consumers and businesses to generate growth rather than extracting it through high taxes. In fact, given the number of tax officers currently working in India, over 94% of tax collection is based on compliance and trust, with only the remaining 6% coming through scrutiny and raids.

Revenue to Demand

Lower indirect taxes raise disposable income, and consumption remains the single largest driver of India's economy, accounting for roughly 60% of GDP. With a marginal propensity to consume of 0.6, the implied fiscal multiplier of 2.5 means that every ₹100 released into household budgets can generate ₹250 in aggregate income.

This demand stimulus is already visible in sectors such as consumer durables and FMCG, where tax rates have been trimmed from 28% to 18% or even 5%.

By leaving an estimated ₹1 trillion–₹1.2 trillion in the hands of middle-income households, GST reform could sustain domestic demand at a time when external growth engines remain weak.

The benefits extend beyond urban consumption.

Lower GST on farm machinery and equipment, now mostly in the 5% slab, has reduced input costs for nearly 400 million farmers, supporting rural purchasing power and food supply chains. A more competitive agriculture sector also complements industrial growth by moderating inflationary pressures, keeping real incomes steady.

Compliance to Competitiveness

The MSME sector, employing over 120 million people, is emerging as one of the biggest beneficiaries of this reform. Invoice-based input tax credits are forcing a move from informal to formal operations, giving small enterprises the credit history needed to access cheaper formal finance.

With working capital freed from refund delays and disputes over classification reduced through rationalised rates, MSMEs can now focus on productivity and scale rather than paperwork.

These structural gains are not trivial. As GST evolves into a seamless value-added tax, it is beginning to reward efficiency instead of compliance. Aligning tax rates on inputs like yarn, fibres, and fertiliser feedstock with those on final goods has reduced cost distortions and improved cash flow for manufacturers. The system's design, faster refunds, uniform rates, and fewer exemptions, are gradually shifting the fiscal mindset from penalising production to enabling it.

Fiscal Maturity

Critics worry that rationalisation could erode near-term revenue. Yet the initial data, and the buoyancy of collections over the past two years, point to a more sustainable outcome: a broad, stable tax base underpinned by higher voluntary compliance. That marks a quiet but important departure from India's long history of fiscal anxiety.

The real macroeconomic gain may therefore be institutional, not arithmetic.

By trusting consumers to spend and firms to grow, India’s policymakers are signalling a shift from revenue maximisation to growth maximisation. The macroeconomics of taxation is ultimately about confidence in the economy’s capacity to generate income faster than the state can tax it.

The mood in the room full of tax administrators was that confidence may be taking root.

More From BasisPoint

RBI policy: Goldilocks, FX, and the Windscreen

Why India Keeps Paying the Psychological Price for the Fed’s Mixed Signals

Sarci-Sense: The Adult Adolescence — Growing Older Without Growing Up

A for Avocado, R for Rizz: The Green That Rewired India’s Tastes

Sections

Economy

Markets

Companies

Policy

More

The Bureau

Canvas

Videos

Even More

Newsletters

StillPoint

Court Unquote

Columnists

About us

Who we are

Our philosophy

Write for us

Contact Us

Privacy Policy

Terms and Conditions