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Bribes, Borders and Middlemen: Why India's GST Is a Game Changer

By Iain Marlow and Enda Curran

New tax reform will reshape India's industrial landscape

'I have not got any training. I only know that GST is coming'

Seized vehicles. Bribes. Days-long delays. Moving goods across Indian states isn't exactly easy -- and that's a major barrier to economic growth.

Rolling a truck of vegetables into Gujarat, the state once governed by Prime Minister Narendra Modi, requires a bribe of 500 rupees to 2,000 rupees even with your papers in order, according to Rakesh Kaul, vice-president of Caravan Roadways Ltd., which has about 400 trucks plying India's pot-holed roads.

But getting past the state tax collectors into Uttar Pradesh, India's most populous state, will cost you more: Upwards of 20,000 rupees, Kaul says. The penalty for not paying off the right people is steep fines from factories whose raw materials are stuck at state borders -- sometimes for as long as five days.



▲ Trucks outside the Caravan Roadways office in Delhi. PHOTOGRAPHER: UDIT KULSHRESTHA/BLOOMBERG

That's why he and other companies are cheering the July 1 implementation of India's biggest tax reform since independence in 1947. The move will replace more than a dozen levies with a new goods and services tax. That should help reduce the immense power India's myriad middlemen wield at state borders, free up internal trade, make it easier to do business and widen the country's tiny tax base.

"Even if your documents are correct, they will find some small error and hold your vehicle," Kaul says in his New Delhi office, located in a dusty trucking depot where hundreds of drivers sit near their brightly painted trucks in the 42-degree Celsius (108-degrees Fahrenheit) heat. "Once GST is there, all that is gone."

Common Market

The new tax would be Modi's most significant economic reform since coming to power in 2014. Yet with less than two weeks to go before its implementation, the government is still refining the details, announcing on Sunday it would relax initial filing requirements for July and August amid concerns businesses were not ready. Despite the last-minute tweaks, Finance Minister Arun Jaitley confirmed Wednesday the tax would roll out on July 1.

While India already boasts one of the world's fastest growing major economies, architects of the reform say it will stoke efficiency and growth by creating a common market of 1.3 billion consumers -- a population greater than the U.S., Europe, Brazil, Mexico and Japan combined.

[Read more: a QuickTake
explainer on the new GST
<https://www.bloomberg.com/po](https://www.bloomberg.com/po)



▲ Arun Jaitley PHOTOGRAPHER: MARLENE AWAAD/BLOOMBERG

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Take the border crossings: Lorry drivers in India lose 60 percent of transit time to road blocks, tolls and other stoppages, which means logistics costs are up to three-times higher than international benchmarks. While truck drivers may still need to stop to have their goods checked, cut that time in half, and logistics costs could fall by up to 40 percent, according to a 2014 World Bank report.

There's no shortage of hyperbole when it comes to describing the GST changes, which took more than a decade of protracted negotiations before Parliament pushed it through. The government's chief economic adviser Arvind Subramanian described it as "transformational."

"The GST is super important," he said in an April interview. "It is also a daring, bold experiment in what I call the good governance of cooperative federalism."

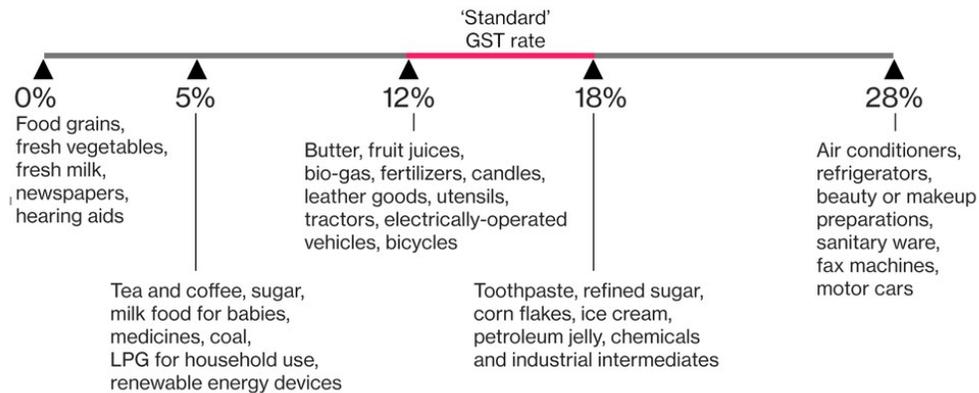
Four Brackets

The GST rollout comes less than a year after the government's surprise [move](https://www.bloomberglitics/articles/2016-11-15/modi-faces-risk-of-economic-stress-as-india-scrambles-for-cash) [in November to remove 86 percent of currency in circulation -- a decision that contributed to a sharp slowing in growth during the January to March quarter. While the GST is seen as a leap forward in simplifying India's system, getting the reform across the line has required compromises: India will have four tax brackets instead of the flat rate many other countries have.](https://www.bloomberglitics/articles/2016-11-15/modi-faces-risk-of-economic-stress-as-india-scrambles-for-cash)

Air conditioners, refrigerators and makeup will be taxed at 28 percent, for example, while toothpaste lands at 18 percent. Plane tickets attract a 5 percent GST rate, but business class tickets are 12 percent. Staples such as food grains and fresh vegetables are not taxed, while education and health services will continue to be exempted.

It's All About The Rates

India GST to lower prices of most mass-consumption products



28% + additional levy: On goods of tobacco products, cigarettes, aerated drinks and motor vehicles

Source: India's Central Board of Excise and Customers

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"India is obviously a huge and complex country in which governments' ability successfully to implement major reforms is limited," said Ian Hall, acting director of the Griffith Asia Institute.

'Different Countries'

The incoming GST will also force companies to consolidate their supply chain among fewer, larger facilities, says Vineet Agarwal, the managing director of Transport Corp. of India Ltd. <https://www.bloomberg.com/quote/TRPC:IN>, which has about 10,000 trucks and around 11 million square feet of warehouses.

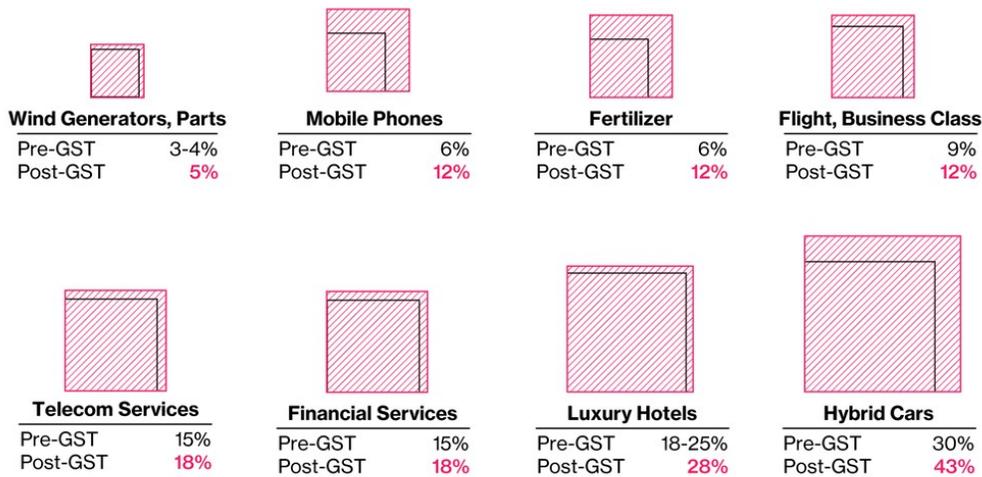
Currently, companies operate smaller factories and warehouses to take advantage of tax breaks offered by various states, as well as to avoid transporting goods over too many borders. "Literally, almost all states act like different countries," Agarwal said.

One of the biggest goals of the GST is to widen the tax net in an economy where more than 90 percent of workers are employed informally. Companies will need to be in the tax system and prove they paid taxes to claim a credit against their costs. Pressure to comply will increase along the line and the black economy should shrink.

Inevitable Disruption

Still, the tax may throw up losers. Manufacturing states may initially suffer as the extra revenue is generated in more populous consuming states. There are also sectors untouched by the new tax, including alcohol and real estate. Thousands of tax staff will also need to be trained and complex new IT systems adopted.

India GST Losers



Note: Rates may vary across states
Sources: ICRA Ltd, CRISIL, SKP Business Consulting LLP

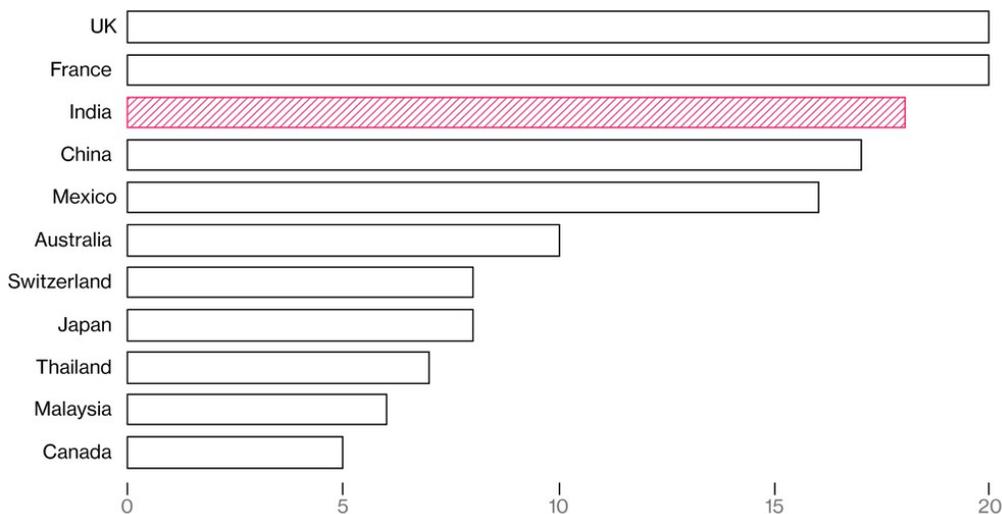
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"There will inevitably be disruption as a result of the implementation of the GST," said Samir Saran, vice president of the New Delhi-based Observer Research Foundation <<http://www.orfonline.org/people-expert/samir-saran/>> .

To be sure, India isn't alone in introducing a new tax that crosses jurisdictions and territories. More than 150 countries have a value added tax or GST including Canada, Australia and the European Union, according to Deloitte.

GST Rate: The Global Picture

India has one of the highest rates among emerging market economies



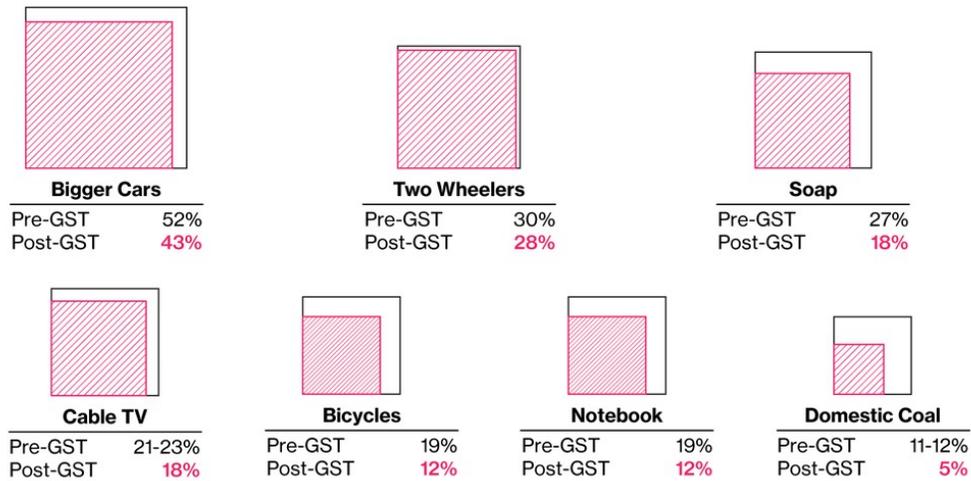
Note: India's majority of items are kept under tax slab of 18 percent
Source: OECD, CBEC, Bloomberg data

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The optimistic case is that initial ruffles are soon smoothed over, according to Eswar Prasad <<http://prasad.dyson.cornell.edu/>> , a professor at Cornell University in Ithaca, New York. "As in the case of the recent demonetization gambit, any

disruption in commerce and economic activity is likely to be short-lived, while the longer-term benefits could be significant," he said.

India GST Winners



Note: Rates may vary across states
Sources: ICRA Ltd, CRISIL, SKP Business Consulting LLP

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Big companies will be prepared, Agarwal at Transport Corp. says, but he frets about the smaller, informal businesses. "There's going to be chaos," he says.

That informal workforce includes Babu Ram Rajput, a 28-year-old trucker in jeans and sandals who regularly drives goods across a vast swathe of north India.

"I have not got any training," he says, holding up a sheaf of tattered, dirty documents related to his current cargo. "I only know that GST is coming."

– *With assistance by Bibhudatta Pradhan, and Hannah Dormido*