

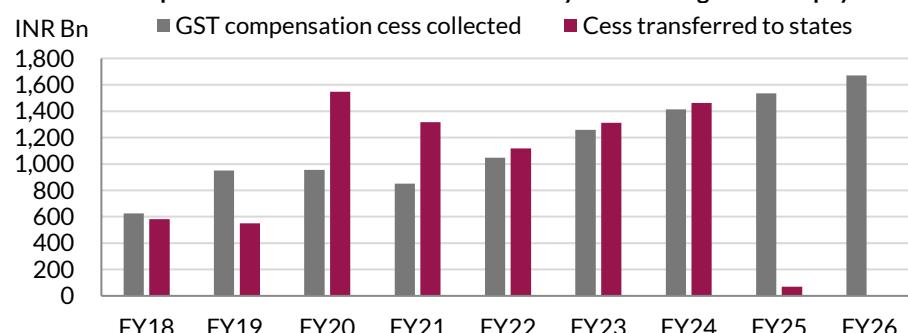
## GST Redesign: Growth positive (0.4pp), but fiscally neutral

Can there be a cut in GST without higher government borrowing? Enter the compensation cess. Over FY18-22, it was collected to compensate states if states' GST grew less than 14% CAGR. As compensation exceeded the cess collected in FY20 & FY21, the center borrowed to fulfil this obligation; cess was extended till FY26 to repay those loans. This boosted growth in FY20 & FY21 (more spending than collection) but hurt growth in FY25 & 1HFY26 (tax collected but used to repay debt/interest). We expect most of this cess to be subsumed in GST (like autos), and the rest, like the cess on tobacco, to get shared with states in some form. This end of off-balance-sheet debt-repayment can boost growth by 0.4pp of GDP.

**August 25, 2025**

Fiscal, Growth

### Exhibit 1 - Compensation cess in FY25-26 went mostly for off-budget debt repayment



Source: CEIC, Axis Bank Research

In our [last report](#), we noted that the worst-case fiscal scenario is that GST receipts would fall Rs1.8tn/year, 0.5% of GDP. In this note, we tighten our estimates and outline the possible next steps to ensure that fiscal consolidation (centre + state) isn't adversely affected.

### Direct revenue loss (centre + state) from discontinued slabs < Rs. 1.4tn

The revenue loss from moving all from items from 12% slab to 5% slab is ~Rs.0.7tn. Most of this loss is certain (unless to lower the compliance burden hotels are shifted to 18%). This is a static calculation and doesn't consider the effect of increased demand. If everything in the 28% slab moves to 18%, there is a further~1tn revenue loss. In practice this would be offset by i) stronger demand as prices fall 7-10%, especially in high-value items like autos; ii) better compliance (Laffer curve); iii) lower input-tax credit claimed on rate cuts on intermediate goods. We estimate a net impact of Rs1.4tn due to these moves.

### End of off-balance-sheet debt-repayment (0.4pp of GDP) to help finance this

In FY25 and FY26 YTD, compensation cess collections were used to service borrowings of Rs2.7tn incurred by the centre to service the 14% GST revenue guarantee to states, and the associated interest costs. This meant fiscal tightening in FY25 and 1HFY26 was more aggressive than seen in headlines as off-balance debt was repaid. As that repayment ends, and the cess equivalents start to flow into fiscal spending, general government borrowing does not need to rise due to the GST slab consolidation. This end of off-balance-sheet debt-repayment can boost growth by 0.4pp of GDP over the next 12 months, in our view.

### More than two-thirds of compensation cess maybe collected in some other form

Of the total compensation cess of Rs1.67tn budgeted in FY26, we estimate that tobacco contributes ~Rs0.6tn in compensation cess, coal Rs0.4tn, autos Rs0.4tn and the rest from products like sugary drinks. Much of this is likely to get subsumed in GST, as products that currently have cess > 5% move to the 40% slab; e.g., for luxury cars, the eventual rate would fall to 40% from 50% earlier, the amount earlier collected as compensation cess would be unchanged (50% - 28% = 40% - 18%). Items like tobacco may need some special treatment, but it is unlikely the government will give up revenue. Thus, there is almost no adverse fiscal impact of the GST redesign on what was earlier collected as compensation cess.

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