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GST and the remapping of India

New tax regime could bring a shift in production and storage centres. It will require a nimble reading of where markets will grow, their logistical requirements

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THE COMING INTO force of the Goods and Services Tax (GST) will unify the nation into a common economic market, obviating the need for goods to be taxed each time they cross a state border. Much of the current discussion about GST has focused on the tax structure and the complexities surrounding the implementation of the new system. Less appreciated is the fact that GST, by changing all aspects of business, from the location of production and investments to logistical and supply-chain optimisation, could fundamentally alter the economic geography of India. To paraphrase the writer Pearl S. Buck, "In our changing world, nothing changes more than economic geography."

Prior to GST, the internal movement of goods was subject to a number of barriers. First, and most directly, there were taxes on the inter-state movement of goods and cross-state differences in VAT structures. Second, there were cumbersome inspections, especially at state borders. A recent World Bank-funded study, undertaken by the Ministry of Road Transport and Highways, used GPS-time-stamped data of freight trucks (collected by the innovative Bengaluru-based logistics company, Blackbuck) to suggest that roughly 20 per cent of the transit time is spent at the border on verification of documents. Indeed, anecdotal evidence suggests that trucks have been taking longer and circuitous routes to avoid inefficient and sometimes corruption-laden border-crossings across some states.

GST will eliminate taxes on inter-state movement and harmonise the VAT structure across states (except for exempted goods). Border inspections should be significantly reduced — although, since inspections of cargo (to ensure GST compliance) and vehicles (for licences and compliance with technical standards, for instance) are still permitted, there remains a concern that harassment by inspectors and corruption may persist. That said, GST is expected to result in a significant increase in internal trade — by as much as 30 to 40 per cent, according to some estimates.

Beyond the increase in internal trade, other economic factors are at play that can significantly alter the economic map of the country. The work of economist Paul Krugman has shown that when the costs of producing a good are lowered with scale in production, there is an incentive to geographically concentrate such production. If additionally, there are large transport costs, production benefits by locating itself near the largest market to minimise transportation costs (the well-known "home-market" effect). In this setting, a reduction in transport barriers, as is the case with GST, can change the location of production within a country quite dramatically — away from the largest market to low production-cost locations, thus diluting the home-market effect. This also holds true in an international setting. Indeed, the relocation of production away from the United States to China in the last couple of decades was driven in significant part by the lowering of transport costs.

With the removal of barriers within India, another related outcome is the geographic centralisation of production and warehousing. This could mean that economic activity will increase in centrally located states such as Madhya Pradesh. Yet another possibility is the agglomeration of economic activity in the more productive states. Thus, with GST, the economic map of India will evolve — possibly in quite complex ways.

As economic corridors change, the demand for new investment in transport and logistics infrastructure will increase. Supplying this demand will require a nimble reading of where markets will grow and where new investments will be necessary. This is crucial as even prior to GST, Indian economic growth implied a near tripling of freight traffic over a decade, with transport infrastructure not quite keeping pace. The costs of inefficient logistics are not inconsiderable. The McKinsey study, *Building India: Transforming the Nation's Logistics Infrastructure*, estimated that logistical inefficiency in India amounts to around 4 per cent of the GDP — this could well increase as the GST intensifies logistical needs

Infrastructure is often identified as a "binding constraint" to growth. Perhaps nowhere is this truer than it is in India today. Much economic and political effort will be required to arrive at optimal investment choices — on the modal mix, the balance between road and rail, air and water, on the location of the vaunted multi-modal logistics "parks", on technology adoption and on the setting of standards (for instance, on containerisation) to support inter modal transport inter alia — and to achieve efficient funding.

India's economic destiny will crucially rely on its ability to anticipate, support and leverage its evolving economic geography. As China's economic trajectory could teach us, productivity and growth require intention and provisioning. They are never mere accidents, they never happen serendipitously.

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