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GST AND INDIAN FEDERALISM: NEGOTIATING CENTRAL AUTHORITY AND STATE AUTONOMY

Dhananjay Kumar Singh [1], Binod Pratap Singh [2]

[1] Research Scholar - Dr. Ram Manohar Lohia Awadh University, Ayodhya (U.P.), India
[2] Professor & Head of the Department of Commerce LBS PG College Gonda Affiliated with Dr. Ram Manohar Lohia Awadh University, Ayodhya (U.P.)

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ABSTRACT

The Goods and Services Tax (GST) introduced in 2017 is one of the seminal fiscal reforms in post-independence India. GST sought to create a single, common market by removing a fractured system of state-level indirect taxes and, in the process, prevent double taxation and eventually improve the economies of scale and productivity of businesses. The reform also changed the nature of India's federal architecture, prompting questions about the balance between central authority and state autonomy. Using the perspective of fiscal federalism, this paper analyses the changes that the introduced GST has brought to the area of financial dependency and political negotiation surrounding the transfer of taxing powers from the states to the Centre.

Relying on secondary statistics from the Reserve Bank of India's reports, the Ministry of Finance's publications, the GST Council proceedings, and existing academic studies, the study highlights three main findings. Firstly, even though the GST has rationalized tax compliance and expanded the tax base, it has also concentrated substantial tax powers, weakening states' fiscal autonomy. Second, while the mechanism for compensating states had been designed to avoid vagaries in state revenues, it has bred dependency in the long run, as emerged so sharply during the COVID-19 crisis when late transfers exposed the underbelly of states. Third, the GST Council was envisaged as a forum of collaboration but exhibits both collaboration and asymmetry, in the sense that the Centre has more power to impose its will.

The paper demonstrates that the GST has been contributing to national economic integration and infringes on the autonomy of states. Reform to preserve India's federal balance involves compensation being paid in a timely manner, the threshold or the need for the financial consent of the states for compensation being reduced and flexibility being provided to more and less fiscally capable states and to differing stages of economic development.

Keywords: GST, fiscal Federalism, State Autonomy, Central Authority, GST Council, Revenue Trends, Cooperative Federalism, India

1. INTRODUCTION

According to the original 1950 Indian constitution, the GST would be the first of its kind in India, because it would subsume central and state taxes. By subsuming a variety of county and central levies, GST claimed it would ease compliance and eliminate multiplicity of taxes, thus making "one nation, one tax" a reality. But beyond its economic and administrative aims, G.S.T. is a constitutional breakthrough in Indian federalism.

Indian federalism's cornerstone is the balance between national integration and state autonomy. India was given the status of "Union of States" at its birth, but fiscal powers have been centralized progressively in its lifespan. GST has only added heft to this course by pooling together the taxing powers of the states (and the Centre) into a twin structure, the control of it lying with the newly formed GST Council. This paper argues that when we focus on the institutional consequences of GST, we need to recognize that the GST has refashioned the Indian federal compact and shifted the focus on contestations between central authority and the state space and reflection on what the current framework signifies in terms of cooperative governance.

2. REVIEW OF LITERATURE

The literature on GST and Indian federalism has focused on two main issues – the economic implications of tax centralization and the political dimensions of central-state relations. Rao (2019) argues that GST has contributed to increasing the centralization of the fiscal structure by pooling the indirect tax powers at the Union level, which means there is a loss of financial autonomy of the states. This, he says, has long-term implications for the fiscal independence of the state and its pre-eminence to spend. Mukherjee (2020c), on the contrary, considers the GST Council as a case of institutional innovation under cooperative federalism where consensus building is in the domain of the constitution. He argues that because of these imbalances inherent in it, the Council is an unrivalled scene for bargaining and cohabitated fiscal governance.

Nonetheless, scholars also highlight vulnerabilities. Until now, states have followed populist policies costless because of easy dependency on compensation transfer (Chakraborty 2021), although it is undeniable that receipt of compensation being a delayed process, it generates a fiscal stress during slowdown. Bagchi (2020) stresses that political bargaining on GST rates and exemptions lays bare structural tensions in federal relations in that the economic powerhouses are likely to be cornered by the central governments, while laggards are to be put more in the thrall of the north block.

Comparative perspectives enrich this debate. In the case of the development of VATs in Canada and Australia, Bird and Gendron (2018) emphasize federations' tensions at large in efforts to balance national efficiency with subnational autonomy. Those examples illustrate the point -- which is that coordination taxes make for better compliance as well as more actually integrated markets, but also the presence of intransigent political fights over fiscal sovereignty.

But even with these contributions, a void still exists. Most of this literature can be characterized as theoretical or macro, dealing with institutional design and economic efficiency. Indian states' experiences "on the ground" in trying to achieve the goals of post-GST fiscal governance have been less well analyzed, in particular, how smaller and poorer states deal with such objectives. Filling this gap in the literature demands linking up the fiscal federalism literature with empirical state outcomes, which is what this paper contributes to.

3. RESEARCH GAP

Scholarships have typically conceptualized GST as either a technical tax reform or as a constitutional experiment in federal governance. However, very few studies offer a limited analysis that relates the economic effects of revenue centralization to the politics governing state independence. In addition, little has been explored as to how smaller or financially weaker states view the impact of GST on their fiscal independence versus the larger and revenue-rich states. This paper aims to address this gap by combining theoretical insights on federal fiscal relations with empirical evidence regarding state revenues and the decision-making processes of the GST Council.

4. OBJECTIVES OF THE STUDY

1) This study aims to pursue the following objectives:
2) To examine the implications of GST for the federal fiscal structure of India.
3) The extent to which GST centralizes power at the expense of the states is something we will be looking to examine.
4) It is our intention to analyze the role of the GST Council as an example of cooperative federalism.
5) To understand the implications of GST on fiscally weaker states and their fiscal autonomy.

5. RESEARCH METHODOLOGY

The research design employed in this study is qualitative and descriptive, and it is based on secondary data analysis. Primary sources include government documents, GST Council minutes, state budget papers, and peer-reviewed research.

Share This Article 22 Pre-GST and Post-GST Revenue Trends It will be noticed from the analysis of data from the Reserve Bank of India's State Finances, A Study of Budgets and Union Ministry of Finance publications in this paper that there is no significant decline in revenue receipts in states following the GST (Chart No. 66). The treatment is mainly conceptual, with technical appendixes provided as necessary, but an effort is made to afford a proper balance to how GST affects the principles, powers, and authorities in the federal state.

6. DATA ANALYSIS AND FINDINGS

The major turning point of both India's fiscal federalism and autocratic government came in the form of the Goods and Services Tax (GST). Its effects have varied from state to state, based on disparate revenue-raising abilities, spending obligations, and political attitudes. This section examines the impact of GST on state finances and on the Centre–state balance through four dimensions: trends of revenue, compensations, functioning of GST Councils and the implications for weaker states.

6.1. REVENUE TRENDS

Prior to the introduction of GST in July 2017, states had a considerable degree of independence in terms of revenue generation by way of catalyzing taxes such as VAT (Value Added Tax), entry tax, luxury tax, purchase tax, and entertainment tax. VAT was the lifeline of their exchequer, providing nearly 40-45 percent of tax revenues for many states (RBI 2016). A few larger states (Maharashtra and Tamil Nadu, for instance) derived gains from their high consumption bases, while smaller resource-poor states (Bihar and the states of the Northeast) depended partially on the whimsical central transfers.

Post-GST, the states gave up much of this freedom. VAT and the other state taxes were rolled into a harmonized structure in which states are guaranteed to be compensated in full for their revenue losses for five years, to make up for the tax credit payouts they owed businesses under the GST regime, apart from states also getting a share of IGST on interstate trade. This move instantly transformed the financial landscape. The Reserve Bank of India's (RBI) State Finances Report (2021) shows that the share of states' own tax revenue in GDP fell from 6.4% in 2016-17 to 5.9% in 2019-20.

The effects are starter when broken down by state. For example:

- Maharashtra had earlier got 47% of its tax revenue from VAT on petroleum and alcohol, but its flexibility has since lessened only since petroleum and alcohol are out of the GST. The tax-to-GSDP ratio of the state has slipped from 7.5% (2016-17) to 6.8% (2019-20).
- Punjab, which relies heavily on VAT for liquor and petroleum, maintained some autonomy in those sectors, but saw buoyancy fall in other revenues. Inflation-adjusted, its tax revenue fell from ₹31,200 crore in 2016–17 to ₹28,900 crore in 2019–20.
- Kerala, which had the highest VAT rate along with entry tax with dependence on surcharge on import VAT, saw a decrease in state tax revenue as a share of GSDP from 8.2% to 7.3% during the same period.

Although the GST system held out hope for efficiency and widespread collections, it also suffered teething troubles (such as compliance confusion, refund delays, and numerous rate changes), which slowed down the revenue stabilization process. The 15th FC (2021) observed that between 2017 and 2020, GST revenues increased by an annual average of 5%, well below the envisaged 14% compensatory benchmark.

6.2. GST COMPENSATION AND STATE FIXED EFFECTS

Acknowledging the transition risk for revenue loss, the GST (Compensation to States) Act 2017 provided for payment of 14% annual growth in tax revenue to the states in the 2015 -16 base year for a period of five years. Compensation was paid out of a cess levied on goods such as tobacco, luxury cars, aerated drinks and coal.

At the outset, compensation payments went through smoothly, enabling states to adapt. In 2017-18 and 2018-19, the Centre, for instance, paid out close to ₹1.25 lakh crore as compensation to states. But as soon as 2019–20 arrived, shortfalls started to appear. Revenue from GST was less than anticipated, and the total compensation requirement for the year was inflated to ₹1.65 lakh crore.

That only got worse during the COVID-19 pandemic. GST revenues took a hit in lockdowns, and monthly collections saw a sharp fall to ₹32,172 crore in April 2020 from the monthly average of ₹1 lakh crore before the pandemic. Redbox, such as Punjab and West Bengal, with hefty fiscal deficits, also reeled under the burgeoning expenditure obligations.

The Centre, facing a revenue shortfall, deferred compensation payouts. By the end of 2020, the deficit stood at ₹2.35 lakh crore. The Union government suggested the states should borrow to cover the deficit, drawing criticism. States like Kerala and Punjab contended that the proposal went against the spirit of federalism. West Bengal called it “a unilateral imposition” that subverted cooperative federalism.

The numbers underscore the growing reliance:

- Compensation grants will form more than 20% of total revenue receipts for smaller states, such as Punjab and Himachal Pradesh, by 2021.
- For bigger states like Maharashtra and Tamil Nadu, the compensation was 8-10% of revenues, large enough to weigh on budgetary planning.

The reliance on this trust called into question its autonomy. States lost their self-sufficient power to change tax rates or enact new taxes. Their fiscal position depended on whether the Centre had both the capacity and the will to transfer compensation on time.

6.3. WORKING OF THE GST COUNCIL

The GST Council, which is the federal decision-making body on GST also formed under Article 279A, is a body without parallel in the Indian federal architecture, which consists of the Union Finance Minister, the Minister of State for Revenue and 25 finance ministers of states. Decisions must be agreed upon by a 75% majority, in which one-third of the votes are with the Centre while the states collectively hold two-thirds. It was intended to avoid unilateralism and yet to consist of a strong central leadership.

However, critics contend the Centre is overpowered. As the Centre holds the veto power and the political upper hand (the ruling party occupies power in many governments), the Centre has guided critical calls on rate rationalization and compliance rules.

But the Council has also shown a willingness to work together. For example:

- In 2018, amid rising concerns about a high burden of high GST rates on essential goods, the Council voted unanimously to reduce rates on 200 items, including sanitary napkins and small appliances.
- The Council had in 2020 during the pandemic agreed to exclude masks, hand sanitizers and ventilators from higher tax slabs to make them more affordable for the public.

Still, tensions persist. Wealthy states such as Maharashtra, Tamil Nadu, and Karnataka want more room to increase or levy surcharges, which the Council has not considered. States also claim that frequent alteration through GST rates, which the center pulls a lot of for its own liking, fails to ensure revenue predictability.

The information shows that between 2017 and 2021 there have been over 45 conferences of the Council, or around 6-7 meetings each year. Although most decisions are reflected as unanimous, dissent notes by states such as Kerala and Punjab indicate that consensus is sometimes more procedural than of substance, So the Council is a kind of hybrid: officially cooperative but operationally skewed toward central authority.

6.4. IMPACT ON WEAKER STATES

For smaller states, particularly the Northeast and hills such as Sikkim, Mizoram, Arunachal Pradesh, and Uttarakhand, GST was initially stabilizing. Pooled funds also allowed such manufacturing-weak states to have both consumption-orientated taxation and compensation transfers.

For instance:

- Destination tax for interstate imports was also a major source of revenue for the state, the GST collection in Arunachal Pradesh had jumped 18% between 2017-18 and 2019-20.
- Dependence on hydroelectric projects and tourism has resulted in Sikkim’s share in GST revenues being equal to 30% of its tax receipts, leading to fiscal stability.

However, this stability is double-edged. These states are increasingly caught in the web of central transfers and no longer enjoy flexibility in designing taxes as per local requirements (like surcharges on tourism, special entry tax, etc.). The fiscal autonomy index of the states, as measured by own revenue to total expenditure, continues to remain low - and well below 25% for most states in the Northeast.

Revenue-rich states, by contrast, have expressed frustration. States with a high manufacturing base (Maharashtra) or a diversified industrial economy (Tamil Nadu) see GST as a loss. At council meetings, both states argued that they subsidized weaker states through pooled revenues. Just Maharashtra's VAT on petroleum, still out of GST, earns ₹30,000 crore per year. The clash between retained autonomy and GST dependence is evident.

These varying views reveal the inequality implications of GST. GST offers survival, but with weaker states chained in dependency. From a stronger state's point of view, GST is a diminution of fiscal innovation and autonomy. Both together add up to a reworked political economy of federalism where the Centre plays the arbiter between stability and flexibility.

7. SUMMARY AND CONCLUSION

Against this backdrop of mirth, the Goods and Services Tax makes an appearance as a unique fiscal reform and experiment in constitutionalism in the context of India's federal polity. It has taken all state-level taxes and brought them under one system and has made the entire country one market, providing it with sound commercial vibrancy. But this reform has also … shackled the federal compact somewhat by concentrating in the Union a huge part of the states' fiscal power of control.

The GST Council, formed to redress this tilt, is a bulwark in favour of cooperative federalism. But there is lopsidedness in the Council's decision-making. While most resolutions are passed by consensus, the voting weight and political power of the Centre can make a significant difference in the outcome. In addition, the COVID pandemic has revealed that states increasingly rely on compensation grants and are financially weak. Delayed transfers and reduced revenues have heightened fears that the GST is eroding state financial autonomy and not promoting cooperative federalism.

This paper tentatively suggests that although the GST has boosted efficiency and national integration, it has also hindered states' ability to generate their own fiscal resources. Indian federalism will continue to be innovative and inclusive only if its reforms concentrate on making fiscal arrangements less unfair. There may also be scoped to give greater prominence to states in the Council's deliberations, institutionalize more predictable compensation flows, and, for states with differing economic profiles, provide flexibility in the pace of change.

Ultimately, GST embodies both the promise and the paradox of Indian federalism; it unifies the economy, yet it threatens to undermine the trust between the Centre and the states. Ultimately, its political legitimacy will depend not only on the revenue it generates but also on whether the states think the system is fair and transparent. It is important to ensure that fiscal reform serves to strengthen and not weaken the federal character of the Indian Union.

CONFLICT OF INTERESTS

None.

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