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## GST and the Changing Landscape of State Finance in India: A Federal Perspective

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### ABSTRACT

The implementation of the Goods and Services Tax in July 2017 marked a significant shift in India's fiscal federal structure. It integrated various indirect taxes into a single tax system. While the Goods and Services Tax aimed to make the tax system more efficient, transparent, and strengthen cooperative federalism, it also raised significant concerns about the fiscal autonomy of states. This study analyzes the changes in central-state fiscal relations following the implementation of the Goods and Services Tax, particularly in the context of the role of the Goods and Services Tax Council, revenue trends, and the states' increasing dependence on the central government. This research is based on a qualitative and analytical methodology and utilizes secondary sources such as government reports, Reserve Bank of India publications, Finance Commission reports, and Goods and Services Tax Council reports. A comparative analysis of the pre- and post-GST periods reveals a decline in the independent revenue-generating capacity of states and increased centralization in fiscal decision-making. The study also analyzes the decision in *Union of India v. Mohit Minerals Private Limited*, which clarified the constitutional status of the Goods and Services Tax Council by deeming its recommendations binding. The study's findings suggest that while the GST has contributed to the creation of a unified national market and improved tax compliance, it has also limited the flexibility of



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states' fiscal autonomy and increased their dependence on the central government. Ultimately, the study concludes that the long-term success of the GST will depend on how it maintains a balance between efficiency and state autonomy.

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## **Introduction**

There is no single model of fiscal federalism that is universally accepted. It depends on a country's specific geopolitical and socio-economic circumstances, as well as the policy objectives that the country seeks to achieve.[1] These objectives include efficiency, equity, and stabilization, as well as regional balance, national integrity, and political stability.[2] One of these objectives is to resolve conflicts between local and national priorities. A federal system implies that the central and state governments operate independently of one another within their respective constitutionally defined spheres of activity, and that they possess substantial financial autonomy which constitutes the backbone of federalism.[3] A modern government is expected to perform a wide range of functions; consequently, every country features distinct levels and departments of governmental authority. For the sake of administrative efficiency and economic prudence, it is advisable to allocate these functions among the various tiers of government. To discharge these functions, these entities require revenue, the management of which is facilitated through a multi-tiered, decentralized fiscal system known as 'fiscal federalism.' Fiscal federalism examines how a country's revenue is distributed among the different levels of government.

## **Conceptual Framework**

### ***Fiscal Federalism***

The concept of fiscal federalism as originally developed by Musgrave [4] and Oates [5] constitutes a sub-field of federalism itself, concerned with the division of policy responsibilities among various levels of government and the fiscal interactions occurring between these governments. The fundamental premise of fiscal federalism is that, while operating within the scope of certain federal constraints, states should formulate their own economic policies rather than merely adhering to the directives of the central government. [6]



An essential aspect of federalism is that states possess the capacity and authority to formulate their own policies and mobilize resources to meet their respective revenue and expenditure requirements within the country; this flexibility is enshrined in the Constitution.

Furthermore, fiscal federalism has come to be recognized as a reform agenda aimed at transferring legislative (regulatory, expenditure, and taxation-related) powers from central or national governments to regional or local governments. These two terms which, sixty years ago, served as a symbol in support of federal government intervention have now evolved into a 'password' for autonomy and decentralization.

The scope of "fiscal federalism" may thus be delineated as follows: [7]

- Which public goods and activities should be provided by which level of government?
- How should the activities of each level of government be financed whether through their own tax sources or through transfers received from the national government?

The term "fiscal federalism" originated in the late 1950s in the United States, a federal nation. At that time, scholars were examining the circumstances under which the federal government possessed the authority and justification to intervene in the affairs of the states. From the outset, three key issues were considered: efficiency, equity, and fairness. Efficiency concerned the potential adverse consequences of budgetary decisions at the state or local level, as well as the methods the federal government could employ to promote efficiency in the overall allocation of resources. Equity related to the federal government's opportunity to regulate the process through which state and local budgets via their respective budgetary policies impact the welfare or income status of people across different states, thereby ensuring that they do not violate the principle of "equal treatment for equals." Fairness addressed the possibility that state budgetary policies might undermine the impact of the tax system on the progressivity of the federal personal income tax.

The term "fiscal" is deemed applicable to both sides of the budget expenditure and revenue; this aligns with the convention wherein "fiscal policy" is considered virtually synonymous with "budgetary policy." The term "federalism" refers to a system of intergovernmental relations in which the fiscal autonomy and budgetary independence of sub-national governments are exercised subject to the guidelines established by the central government regarding certain of their activities. Thus, viewed from a different perspective, "fiscal federalism" constitutes a system in which the central government possesses only limited powers whether in terms of the functions it performs or the interventions it undertakes in the affairs of sub-national governments.



## ***Goods and Services Tax***

The Goods and Services Tax (GST) has proven to be a pivotal moment in the evolution of India's fiscal federal structure. By subsuming various indirect taxes levied by both the Central and State governments into a single, unified tax system, the GST has fundamentally transformed Center-State fiscal relations. [8] This reform was presented as a step toward strengthening cooperative federalism, fostering coordination, streamlining tax-sharing mechanisms, and institutionalizing collaborative decision-making through the GST Council. [9] While the government promised efficiency and 'Ease of Doing Business' at the time of the GST's implementation, the States were required to cede a significant degree of their fiscal autonomy in the process. In return, the States were assured of revenue compensation and equal representation within the GST Council. However, with the passage of time, concerns have emerged regarding revenue uncertainty, delays in compensation payments, and increasing fiscal centralization. [10]

### **Background**

Prior to the implementation of the Goods and Services Tax system in July 2017, India operated under a complex and corruption-prone regime comprising Value Added Tax (VAT), excise duties, service taxes, and numerous other indirect levies. This entire system was highly confusing and convoluted. Following the introduction of the GST system in July 2017, the old, cumbersome indirect tax structure was replaced by the GST tax slab system a framework far simpler and more streamlined than its predecessor. Although this system represents a significant improvement over the past, it remains neither entirely simple nor completely trouble-free, despite establishing a clear demarcation of fiscal powers between the States and the Central Government. Given the multi-tiered slab structure and the lack of specific revenue targets, how exactly is tax collection to be effectively managed? These issues have now been identified and must be resolved to maximize the benefits of the Goods and Services Tax (GST). Almost every citizen has, at some point, encountered or paid this indirect tax known as the Goods and Services Tax. The current GST system in India divides the tax into four main components: State GST (SGST), Central GST (CGST), Union Territory GST (UTGST), and Integrated GST (IGST). These four primary GST categories are further classified into four tax slabs: 5%, 12%, 18%, and 28%. Now, let us examine various products to determine which of these four slabs they fall under. This presents a dilemma that has perplexed not only producers and manufacturers but also policymakers; it can be argued that there is no clear distinction between different products assigned to different tax slabs or, even if a distinction exists, it is often negligible and, to date, no definitive solution to this dilemma has been found.



### ***The Goods and Services Tax System***

As mentioned in the previous section, prior to the implementation of the Goods and Services Tax system, numerous indirect taxes existed, rendering the entire process highly complex. This issue was highlighted in the report by the GST Task Force, which stated that the Indian tax system was leading to the inefficient allocation of resources and hindering the country's economic development. Furthermore, the previous system suffered from several loopholes that shrewd and corrupt businesspersons exploited to evade taxes. Many individuals also complained that the tax burden was cumulative, resulting in a cascading effect. Prompted by these grievances and the recommendations of the task force, the Goods and Services Tax was implemented in 2017. The GST system in India is a 'destination-based' (or consumption-based) value-added tax system as the name implies levied on the production, sale, and consumption of goods and services across all states of India. What is the Value-Added Tax system? Simply put, this tax is levied and collected at every stage of value addition during the production and sale of goods and services.[11] India's Goods and Services Tax system bears a strong resemblance to, and is inspired by, Canada's Goods and Services Tax model. For several reasons including the similarities between the systems of both nations both India and Canada adhere to a federal system of governance. The Goods and Services Tax system in India and Canada is similar.[12]

The Indian Goods and Services Tax (GST) system comprises the following components: Central Goods and Services Tax (levied by the Centre), State Goods and Services Tax (levied by the States) / Union Territory Goods and Services Tax (levied by the Union Territories), and Integrated Goods and Services Tax (levied by the Centre on inter-state transactions of goods and services). The current GST system can be characterized as a streamlined tax regime, as it imposes a single tax on both goods and services. Furthermore, the existing system has eliminated the 'cascading effect' (the effect of tax on tax) and has curbed tax evasion by making the system more robust than ever before.[13]

Initially, GST rates were categorized into several slabs, including 0%, 5%, 12%, 18%, and 28%. Daily necessities were taxed at lower or zero rates, while luxury items were subject to higher tax rates. Now, in September 2025, 'GST 2.0' aims to simplify this framework even further. The new structure takes steps to consolidate tax rates into fewer slabs, thereby making regulatory compliance easier for businesses and reducing the tax burden on common consumers. Higher rates have been retained for certain luxury and demerit goods, while essential commodities have been granted relief. Overall, the objective of GST 2.0 is to make the tax regime simpler, more transparent, and more efficient, thereby safeguarding revenue while simultaneously boosting economic activity.



The rationale behind these slabs is to place essential goods and food items within the lower tax brackets, while positioning luxury goods and demerit goods at the highest tier of the tax structure. An exception to this rule is gold, which falls under a distinct category. Raw, precious, and semi-precious stones are taxed at rates of 3% and 0.25%. [14]

The Goods and Services Tax (GST) Council of India determines the categorization of the aforementioned tax slabs and formulates the entire GST policy. The GST Council of India was constituted on September 15, 2016, and its provisions were incorporated into the Indian Constitution through the 122nd Amendment, under Article 279A. The authority to appoint members to the GST Council rests with the President, and the Union Finance Minister serves as its Chairperson. In addition to the functions mentioned above, the Council's primary role is to provide recommendations regarding tax rates, exemptions, and other related matters. Decisions within the GST Council are taken following a duly convened meeting and a vote by majority. However, interestingly, the Council has, to date, taken most of its decisions through consensus. The Central Government holds a 33% voting share, while the representatives of the States collectively hold a 66% share. [15]

The GST system has simplified tax compliance and payment procedures for users, while also rendering tax administration more streamlined and convenient. The key elements of a robust tax system include minimal compliance costs, taxpayer-friendly compliance mechanisms, and a simple, straightforward approach to both compliance and administration. The previous tax regime lacked these characteristics; conversely, the new GST system fulfills all the essential requirements of an effective tax system: it is taxpayer-friendly, easy to comply with and administer, and has successfully reduced compliance costs. A prime example of the current system's taxpayer-friendly nature and ease of compliance is the Composition Scheme. This scheme was specifically designed to benefit small businesses that cannot afford the financial burden associated with the regular GST scheme. Under this scheme, tax rates as well as paperwork and compliance requirements have been significantly reduced to cater to the specific needs of these small businesses and to simplify the processes of compliance and tax payment for them. However, one notable caveat is that those who opt to pay taxes under the Composition Scheme will be unable to claim or avail the benefits of Input Tax Credit. It is interesting to note that since its inception, and based on the requirements and recommendations of the Goods and Services Tax (GST) Council, numerous reforms and amendments have been introduced almost every year to further refine the GST system and to address various issues and shortcomings. A recent example of such a reform which has made the system more taxpayer-friendly and easier to comply with is the removal of the GST registration requirement for traders and businesses dealing in goods and services that are exempt from



taxation under the GST regime (simply put, goods and services falling under the 0% tax slab). Thus, it can be concluded that the GST system possesses numerous positive aspects. At the same time as is the case with any other subject of discussion not everything regarding GST is entirely positive. A major concern raised regarding the GST system pertains to its impact on the financial autonomy of the states and the GST Council itself. Let us now examine what the GST Council is and how it functions, so that we may analyze the potential impact it could have on the financial autonomy of the states.

### **Research Questions**

- What has been the impact of the implementation of the Goods and Services Tax (GST) on the fiscal autonomy of states in India?
- What is the role of the GST Council in the fiscal decision-making process of the states?
- Does the GST strengthen cooperative federalism, or does it lead to increased fiscal centralization?
- Has the GST had any impact on the revenue-generating capacity of individual states?

### **Hypotheses**

- The implementation of the GST has diminished the fiscal autonomy of states in India.
- The GST Council has fostered centralization within the fiscal decision-making process.
- The GST has had a differential impact on the revenue-generating capacity of the states.

### **Research Methodology**

This study adopts a qualitative and analytical approach to examine the impact of the Goods and Services Tax (GST) on the fiscal autonomy of states in India. It is based on secondary data. The data sources for this study include reports from the Reserve Bank of India (RBI) and the Finance Commission, minutes of GST Council meetings, government publications, and relevant academic literature. A comparative analysis of the pre-GST and post-GST periods has been conducted to assess the changes observed in state finances. This study also employs a descriptive and explanatory approach to analyze revenue trends, the role of the GST Council, and the states' increasing reliance on central transfers. Furthermore, to understand the constitutional status of the GST Council and its implications for fiscal federalism, the judgment delivered in the case of \*Union of India vs. Mohit Minerals Pvt. Ltd.\* has also been taken into consideration.



**Economic and Political Weekly (2018)**[16] noted that the implementation of the Goods and Services Tax (GST) in India has significantly improved the efficiency of the indirect tax system. This was made possible by the elimination of various cascading taxes (taxes levied one upon another), which facilitated the creation of a unified national market. However, the study also emphasized that serious challenges have emerged regarding the fiscal health of the states particularly in terms of maintaining stable sources of revenue. A key observation in this context is that the shift toward a 'destination-based tax system' (a consumption-based taxation model) has altered the traditional revenue structure of the states. This has generated uncertainty and, particularly for manufacturing-intensive states, resulted in short-term revenue losses. The analysis concludes that while the GST has undoubtedly enhanced tax efficiency and economic integration, the transitional phase has simultaneously created fiscal stress and revenue volatility for the states. Consequently, concerns regarding the fiscal stability of the states within the federal framework have intensified.

**PRS Legislative Research (2020)**[17] An analysis regarding the Goods and Services Tax Council reveals that it is a unique constitutional body established to foster cooperative federalism by bringing together the Central and State governments to make collective decisions concerning indirect taxation. However, the study also points out that an inherent power imbalance exists within the institutional structure of the Council. Although decisions are ideally based on consensus, the voting structure grants the Central government a significant advantage, as it holds one-third of the total voting power, whereas decisions require a three-fourths majority. This effectively grants the Centre veto-like powers, thereby limiting the states' capacity to make independent financial decisions.

**RBI (2020)**[18] observed that the impact of the Goods and Services Tax (GST) on state revenues has not been uniform. The report notes that in 2019–20, the growth rate of states' own tax revenue slowed down to approximately 6–7%, whereas this pace was significantly faster prior to the implementation of the GST. It further points out that the targeted 14% guaranteed growth in compensation could not be achieved, leading to increased compensation requirements. Since the GST contributes approximately 40–45% to states' own tax revenue, many states have become heavily dependent on the performance of the GST and on funds received from the Centre. Overall, while the GST has undoubtedly improved compliance, its outcomes have been mixed for several states, resulting in increased financial pressure on them.

**Rao, M. G. (2022)**[19] In his article, presents a critical analysis of the changes in Center-State financial relations in the post-Goods and Services Tax (GST) era. The author argues that while the GST has



contributed to bringing uniformity in taxation and improving the efficiency of the indirect tax system, it has also augmented the power of the Central Government in the realm of fiscal governance. Rao emphasizes that the centralization of indirect taxation under the GST regime has curtailed the fiscal space available to the states and placed curbs on their independent decision-making powers. Furthermore, he points out that the institutional mechanisms designed for mutual dialogue and bargaining between governments have weakened particularly within the GST framework where the scope for states to influence key fiscal decisions is significantly limited. Consequently, he has expressed concerns regarding fiscal centralization in India and the erosion of 'cooperative federalism.'

**Mukherjee (2022)**[20] presents a comprehensive empirical assessment of the revenue performance of the GST and its impact on the finances of both the Central and State governments in India. This study compares revenue sources during the pre-GST and post-GST periods, concluding that following the implementation of the GST, neither the Center nor the States have been able to fully achieve their objectives regarding enhanced revenue mobilization. Although the GST was expected to boost efficiency by expanding the tax base, improving tax compliance, and eliminating the 'cascading effect' (the levy of tax on tax), the study reveals that revenue gains have been uneven; in many instances, they have proven insufficient to even match the trends observed in the pre-GST era. This research paper also includes an analysis of the Goods and Services Tax (GST) compensation mechanism, highlighting that state governments have succeeded in sustaining their revenue sources primarily due to compensation transfers and 'back-to-back' loans provided by the Central Government. However, the study cautions that reliance on compensation renders states economically vulnerable, particularly once the compensation period expires. Furthermore, the study indicates that states with a high dependency on GST compensation as well as on the State GST component of their own tax revenue such as Punjab, Goa, and Chhattisgarh, are more likely to face fiscal crises compared to other states. The study concludes that while the GST has undoubtedly improved tax harmonization and administrative efficiency, its impact on state finances raises concerns regarding fiscal autonomy and long-term revenue stability. Thus, it underscores the persistent challenges inherent in India's fiscal federal structure.

**Joseph and Kumari (2023)**[21] have conducted an in-depth examination of the Goods and Services Tax (GST) framework from the perspective of Indian fiscal federalism, placing particular emphasis on its impact on state finances. The authors argue that, although the GST was hailed as a transformative reform aimed at strengthening cooperative federalism through a unified tax structure, its operational design has not fully achieved the intended objectives of revenue neutrality and balanced fiscal relations between the Centre and the States. They highlight that the GST Council despite serving as a platform for cooperative



decision-making reflects an inherent asymmetry in fiscal power, wherein the Central Government exerts disproportionate influence over tax policy decisions. Furthermore, the study finds that the fiscal autonomy of the states has declined due to the erosion of independent taxation powers and an increasing reliance on the GST compensation mechanism. Taking Kerala as a case study, the authors demonstrate that the implementation of the GST has placed a strain on state revenues, resulting in a persistent dependence on transfers received from the Centre. They conclude that, rather than fully strengthening cooperative federalism, the GST has gravitated toward fiscal centralization or a form of "coercive federalism" thereby altering the landscape of state finances in India in a manner that raises concerns regarding long-term fiscal autonomy and equity among the states.

**Singh, G. (2025)**[22], analyzing the impact of the GST on India's fiscal federal structure, argues that although the GST was implemented with the objective of promoting efficiency and a unified tax system, this reform has nonetheless resulted in increased fiscal centralization. He has highlighted that the subsumption of major state taxes under the Goods and Services Tax (GST) has diminished the fiscal autonomy of the states and increased their dependence on central transfers. He has also criticized the functioning of the GST Council, pointing out that its decision-making structure often tilts in favor of the Centre, thereby fostering a sense of mistrust between the Centre and the states. Furthermore, the increasing use of cesses and surcharges, along with issues surrounding GST compensation, has further constrained state finances. Overall, he concludes that while the GST has improved tax coordination on the one hand, it has, on the other, undermined cooperative federalism and the fiscal independence of the states.

**Bhagat (2025)**[23] has examined the impact of the GST on the balance between efficiency and state autonomy within India's federal structure. He argues that the GST has significantly improved tax coordination by establishing a unified indirect tax system and by reducing the inefficiencies associated with a multiplicity of taxes. However, he also emphasizes that these benefits have been achieved at the cost of reduced financial autonomy for the states. He asserts that the centralization of tax powers coupled with the states' growing reliance on the GST Council and central transfers has tipped the balance of financial authority in favor of the Central Government. Consequently, he notes that while there have been improvements in administrative efficiency and tax harmonization, the concomitant shift toward fiscal centralization has heightened concerns regarding the weakening of cooperative federalism in India.

Existing studies suggest that the GST has improved India's tax system by making it more efficient and transparent. However, it has also raised certain concerns regarding fiscal federalism. Most research



indicates that states have ceded some of their fiscal autonomy and have become increasingly dependent on the Centre and institutions such as the Goods and Services Tax (GST) Council. The literature also suggests that the GST Council originally established to foster cooperation between the Centre and the states has, in practice, further centralized the decision-making process. This implies that the Centre has assumed a more dominant role in fiscal decision-making compared to the states. Studies further emphasize that the GST has not had a uniform impact across all states; some states particularly during the initial years of its implementation faced revenue-related challenges and fiscal pressures, leading to an increased financial dependence of the states on the Centre.

## Conclusion

### *The Goods and Services Tax Council and State Autonomy*

According to Article 279A(1) of the amended Constitution, it is mandatory for the President to constitute the Goods and Services Tax (GST) Council within 60 days from the date on which the said Article comes into force. The notification for this provision which became effective on September 12, 2016 was issued two days prior, specifically on September 10, 2016. The GST Council functions as a collaborative body comprising both the Central and State governments. Its membership includes the Union Finance Minister (serving as Chairperson), the Union Minister of State for Revenue or Finance, and the Finance or Taxation Minister (or their representative) from each State. Article 279A(4) delineates the Council's role in advising the Central and State governments on various matters related to the Goods and Services Tax. These responsibilities encompass identifying taxable and tax-exempt goods and services, drafting model GST laws, and formulating principles for determining the place of supply. The Council also recommends special rates for mobilizing resources during emergency situations such as natural disasters and provides guidance on specific rules for the States whenever necessary.[24]

It has been argued that the voting mechanism and decision-making processes of the GST Council have significantly undermined the financial autonomy of the States. The GST Council operates on a 'weighted voting system,' wherein the Central Government holds a one-third share (1/3) of the total votes, while the remaining two-thirds (2/3) of the votes are collectively held by all the States. However, the inherent issue here is that for any proposal to be approved, it requires the support of three-fourths (3/4) of the votes cast in its favor. As a result of this, the Central Government can, at its own discretion, stall any decision and, to a certain extent, centralize power in its own hands.[25]



This imbalance of power between the Centre and the States wherein the States possess limited authority within the Goods and Services Tax (GST) Council, the principal institution governing the GST raises significant questions and concerns regarding federalism and fiscal autonomy within the GST framework. As has been alleged and as is evident from the structure and procedures of the GST Council the current GST regime substantially curtails the States' power to formulate their own fiscal policies without any central interference or influence. This allegation and criticism stem from the fact that, under the previous VAT regime, States enjoyed considerable autonomy in formulating their tax policies and determining their tax rates. Different States maintained varying tax rates based on their respective specific needs. This arrangement was more closely aligned with a "federal structure," a feature that has now allegedly been stripped away and undermined. While the previous system granted greater autonomy to the States, it also as noted earlier rendered the conduct of business more difficult and cumbersome. The *\*Mohit Minerals\** case stands as a landmark judgment that has played a pivotal role in keeping this discourse on the 'GST Council and Federalism' alive.[26]

In this case, the Court primarily analyzed the legal requirements for the constitution of the Goods and Services Tax (GST) Council and reiterated what was already stated on paper: that the recommendations of the GST Council are binding neither on the Centre nor on the States. Although this was not the central issue of the case but rather a secondary outcome and observation by the Court this particular ruling proved to be the most widely discussed and controversial aspect; indeed, the case attained its status as a landmark and celebrated judgment solely due to this specific outcome.[27] It is often argued that the verdict delivered in the *\*Mohit Minerals\** case was misinterpreted by many. Many perceived it as a severe blow to the very existence and authority of the GST Council. Since the Court characterized the Council's directives merely as "recommendations" rather than mandatory orders it theoretically implied that either the State or the Central government could easily decline to implement the Council's recommendations, despite their formal existence on paper. However, in practice, this has not occurred. Studies indicate that the GST Council serves as an exemplary model of "cooperative federalism," wherein the Central and State governments convene jointly to deliberate upon various recommendations and objections regardless of which party raises them and ultimately arrive at a consensus. Furthermore, even though this consensus technically constitutes a mere "recommendation," both the State and Central governments consistently implement it for their mutual benefit. The 54 meetings held by the Council to date, along with the recommendations emanating from them, have proven to be highly beneficial and constructive.[28]



Critics, however, argue that the Central government exercises excessive control. Given that the Central government possesses veto power and significant political leverage (as the ruling party at the Centre often holds power in several State governments), it has effectively steered key decisions regarding rate rationalization and compliance regulations. Nevertheless, the Council has also demonstrated a genuine willingness to function collaboratively. For example:

In 2018, amidst growing concerns regarding the burden of high Goods and Services Tax (GST) rates on essential items, the Council unanimously voted to reduce rates on 200 items, including sanitary napkins and small appliances.

In 2020, during the pandemic, the Council agreed to exempt masks, hand sanitizers, and ventilators from higher tax slabs so that they could become more affordable for the general public.

Nevertheless, tensions persist. Wealthier states such as Maharashtra, Tamil Nadu, and Karnataka seek greater latitude to increase or impose surcharges, a request that the Council has not entertained. The states also contend that frequent changes to GST rates implemented unilaterally by the Centre disrupt revenue projections.[29]

### ***Revenue Trends***

Prior to the implementation of the Goods and Services Tax (GST), states enjoyed considerable autonomy in mobilizing revenue through taxes such as VAT (Value Added Tax), Entry Tax, Luxury Tax, Purchase Tax, and Entertainment Tax. VAT served as a significant source for their exchequers, contributing approximately 40–45 percent of the tax revenue for many states. Some larger states (such as Maharashtra and Tamil Nadu) benefited from their extensive consumption bases, whereas smaller, resource-constrained states (such as Bihar and those in the Northeast) relied to some extent on discretionary transfers from the Centre. Following the introduction of the GST, states were compelled to cede a significant degree of their fiscal autonomy. VAT and other state-level taxes were subsumed into a unified framework; in return, states were guaranteed full compensation for any revenue losses incurred over a period of five years specifically to offset tax credit payouts made to businesses under the GST regime. Additionally, states were allocated a share of the Integrated Goods and Services Tax (IGST) levied on inter-state trade. This measure immediately transformed the fiscal landscape. The Reserve Bank of India's 'Report on State Finances' (2021) reveals that the share of states' own tax revenue in the GDP declined from 6.4% in 2016–17 to 5.9% in 2019–20. Following a figure of 6.7% in 2022–23, the share of states' own tax revenue in the GDP witnessed a decline of approximately 0.7 to 1.2 percentage points in



2023–24; conversely, the budgetary estimates for 2024–25 indicate a projected increase of 0.5 to 1.2 percentage points. However, this situation is unbalanced, as it was assumed that state revenue would increase annually as a result of the Goods and Services Tax (GST).[30]

For example:

- Maharashtra previously derived 47% of its tax revenue from VAT levied on petroleum and liquor; however, since petroleum and liquor were excluded from the ambit of the GST, this revenue stream has diminished. The state's tax-to-GSDP ratio declined from 7.5% (2016-17) to 6.8% (2019-20).
- Punjab, which relies heavily on VAT levied on liquor and petroleum, retained a degree of autonomy in these sectors but witnessed a decline in other revenue streams. After adjusting for inflation, its tax revenue fell from ₹31,200 crore in 2016-17 to ₹28,900 crore in 2019-20.
- Kerala which had the highest VAT rates and relied on entry taxes and surcharges on import VAT witnessed a decline in its state tax revenue, as a share of GSDP, from 8.2% to 7.3% during this same period. Although the GST system was expected to deliver strong performance and substantial collections, it encountered initial teething troubles (such as confusion regarding compliance, delays in refunds, and frequent changes in rates), which slowed down the process of revenue stabilization. The 15th Finance Commission (2021) observed that GST revenue witnessed growth between 2017 and 2020.[31]

### ***Impact on Weaker States***

For smaller states particularly those in the Northeast and the hill regions, such as Sikkim, Mizoram, Arunachal Pradesh, and Uttarakhand the GST initially proved to be a stabilizing factor. Thanks to the pooled funds, these states which are weak in manufacturing were able to receive both consumption-based taxes and compensation. For instance, for these states, the 'destination tax' levied on goods arriving from other states served as a major source of revenue; in Arunachal Pradesh, Goods and Services Tax (GST) collections witnessed an 18% increase between 2017-18 and 2019-20. Due to its reliance on hydroelectric projects and tourism, Sikkim's share of revenue derived from GST has reached up to 30% of its total tax collection, thereby providing it with economic stability. However, this stability acts as a double-edged sword. These states are becoming increasingly dependent on funds received from the Centre and can no longer exercise the freedom to determine taxes according to their specific local needs (such as surcharges on tourism, specific entry taxes, etc.). The states' 'Index of Fiscal Autonomy' (measured by the ratio of their own revenue to their total expenditure) remains consistently low and for



most Northeastern states, it stands significantly below 25%. Conversely, high-revenue states have expressed their discontent. States with a strong manufacturing base (such as Maharashtra) or those with diversified economies (such as Tamil Nadu) appear to be incurring losses under the GST regime. During Council meetings, both these states have argued that they are effectively subsidizing the weaker states through the revenue generated from pooled taxes. Maharashtra alone generates an annual revenue of ₹30,000 crore solely from VAT on petroleum (which currently remains outside the ambit of GST).[32] The inherent tension between residual fiscal autonomy and dependence on GST is clearly evident. These divergent perspectives highlight the distributional and inequality-related impacts of the Goods and Services Tax. While the Goods and Services Tax provides a lifeline for states to survive, it simultaneously shackles weaker states in the fetters of dependency. Viewed from the perspective of a strong state, the Goods and Services Tax represents a measure that curtails both fiscal innovation and autonomy. Together, these two factors weave the fabric of a new political economy of federalism, in which the Central Government assumes the role of an arbiter between stability and flexibility.[33]

### Suggestions

Indian federalism can remain innovative and inclusive only if the primary objective of the reforms undertaken within it is to establish fiscal arrangements that are more precise and streamlined. There is ample scope to accord greater significance to the states during GST Council meetings, to ensure greater certainty by institutionalizing the flow of compensation grants, and to introduce flexibility in the pace of transition for states with diverse economic profiles. Ultimately, the GST encapsulates both the promises of Indian federalism and its inherent contradictions. While it serves to integrate the economy, it also poses the risk of eroding mutual trust between the Centre and the States. Ultimately, its political legitimacy will depend not merely on the revenue it generates, but also on the extent to which the states perceive the system to be fair and transparent. It is imperative to ensure that fiscal reforms are designed in a manner that reinforces rather than undermines the federal character of the Indian Union.

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