

POLITICAL ECONOMY OF GST- COOPERATIVE VS COMPETITIVE FEDERALISM

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ABSTRACT

The Goods and Services Tax (GST), introduced on July 1, 2017, through the 101st Constitutional Amendment Act, marked a monumental shift in India's indirect tax regime. It aimed to create “one Nation, one Tax “by subsuming multiple central and state taxes. This reform has profound implications for India's quasi-federal structure, fundamentally altering the fiscal relationship and power dynamics between the Union and State governments. It has reshaped both cooperative and competitive aspects of Indian federalism, fostering greater integration while simultaneously raising concerns about fiscal autonomy.

Keywords: GST, Cooperative Federalism, CGST, IGST, SGST, UTGST

INTRODUCTION

Today, India is now becoming one of the most powerful economies of the global world. To meet this expectation, there are various steps which are being taken to give its final shape GST has been implemented in India keeping all the points into consideration. GST is considered the largest step in the field of tax reforms in India. Though India is not the first country to introduce GST, there are various countries in the world that have already implemented. GST was first introduced in France in the year 1954. After its successful implementation, other countries have followed it. The implementation of GST in India may also be considered important because India is a country as well as a sub-continent and she has a huge federal system. It makes India different from other countries adopting GST.

GST – Its Background

After 1947, the basic features of Indian economy compelled India to adopt the mixed economy. In 1991, the Government of India adopted economic reforms at the recommendations of Narasimham Committee. The policy of liberalisation was adopted to make changes in economic sector. These situations also changed the way of doing business. Before reforms, there was no competition in global market. After reforms, our industries started facing global challenges. To make India more efficient in the field of production and robust in economic sector, GST was implemented in India on 1 July 2017. The Prime Minister of India announced the implementation of GST in the meeting of Niti Ayog which shows the strength of its federal system and strong desire of a country.

The introduction of GST in India was made in various steps with some political obstacles. Many amendment bills were brought into action. In 2011, 115th Amendment Bill was also introduced in Parliament but nothing could be done. The bill was again introduced in 2014 for discussion in Parliament but that time the Parliament was dissolved and finally the bill was also lapsed.

In December 2014, the Constitution (122nd Amendment) Bill was introduced in the Lok Sabha and it was passed from there in May 2015. The Bill was then taken up in Rajya Sabha and was referred to the Joint Committee of Rajya Sabha and Lok Sabha in May 2015. On

22nd July, 2015, the Select Committee submitted its report and thereafter, the Constitutional Amendment Bill was moved for political consensus on August 1, 2016. The Bill was passed by the Rajya Sabha on 3rd August 2016 and by the Lok Sabha on 8th August 2016. The Constitutional Amendment Bill was notified on 8th September, 2016 as Constitutional (101st Amendment) Act 2016 after ratification by required number of state legislatures and assent of the President. This amendment created opportunity for introduction of Goods and Services Tax in India.

Later on, the Central Goods and Services Tax Bill, 2017 (CGST Bill), the Integrated Goods and Services Tax Bill 2017 (IGST Bill), The Union Territory Goods and Services Tax Bill 2017 (UTGST Bill), the Goods and Services Tax (Compensation to the States) Bill 2017 (The Compensation Bill) were passed by the Lok Sabha on 29th March 2017 after approval from GST Council. These Bills were passed by the Rajya Sabha on 6th April 2017 and were enacted as Acts on 12th April 2017. Thereafter, the different states through State Legislatures passed State Goods and Services Tax Bills. After the enactment of GST Laws, Hon'ble Prime Minister of India, Shri Narendra Modi launched GST in India with effect from 1st July 2017 in the presence of Shri Pranab Mukherjee, the then President of India at Central Hall of Parliament of India.

The implementation of GST in India is the best example of federal system. India is a country of 29 states and 7 Union Territories in which more than half of the states have BJP led governments and other states led by opposition parties for example, Delhi and West Bengal have governments of parties opposite to each other. In such a situation, there was a need to make coordination between all the states and that is why much thrust is given on cooperative federation. Under this system, the powers of centre and the states have been defined which will strengthen the relation between centre and the states in terms of tax reforms. The fundamental principle of federal system is that there must not be any law which creates differences between centre and states. Cooperative federation is a philosophy in which sovereignty is shared by centre and state governments and they work together in some areas share their functions and finally power. Prior to GST, there were complications/problems between centre and states in terms of tax system. Taking all the disputable points into consideration the GST has been introduced on the basis of "One Tax, One Nation" so that India may move towards development.

Implications of GST on Indian Federalism

The GST regime has significantly transformed the landscape of Indian federalism, presenting both opportunities for enhanced cooperation and challenges to state autonomy. This dual impact is critical to understanding the evolving Centre-State relations.

Positive Implications: Promotion of Cooperative Federalism and Economic Integration

- a. **GST Council: A Unique Federal Institution:** The GST Council, established under Article 279A, is a collaborative body comprising the Union Finance Minister and state finance ministers. It serves as a platform for consensus-based decision-making on tax rates, exemptions, and administrative procedures, embodying the spirit of cooperative federalism. This unprecedented institutional mechanism fosters dialogue and joint ownership of tax policy.
- b. **Harmonised Tax Structure and Common Market:** By replacing multiple cascading taxes, GST has streamlined the taxation process and eliminated inter-state trade barriers. This has led to the creation of a unified national market, promoting economic integration and efficient allocation of resources across states.

- c. **Enhanced Transparency and Compliance:** The simplified tax structure and integrated digital platform (GSTN) have improved transparency and reduced tax evasion, leading to better tax collections for both the Centre and states in the long run.
- d. **Destination-Based Consumption Tax:** GST is a destination-based tax, meaning revenue accrues to the consuming state rather than the producing state. This can benefit states with higher consumption, potentially leading to a more equitable distribution of revenue in certain scenarios.

Negative Implications: Challenges to Fiscal Autonomy and Revenue Concerns

1. **Erosion of State Fiscal Autonomy:** States have ceded significant power to levy independent indirect taxes (like VAT, entertainment tax, luxury tax) that constituted a substantial part of their revenue. This limits their flexibility to tailor tax policies to specific local economic needs or to raise revenue independently.
2. **Centralisation of Taxation Powers:** While the GST Council is a joint forum, critics argue that the Centre holds significant sway due to its one-third voting power and the consensus-driven approach, which can sometimes lead to a unitary bias in decision-making.
3. **Revenue Shortfalls and Compensation Issues:** Many states, particularly during the initial years and post-COVID-19, experienced revenue shortfalls. The GST Compensation Cess, designed to offset state revenue losses for the first five years (till June 2022), has expired, leading to renewed fiscal pressures and dependence on central transfers. States like Kerala faced significant deprivation in transfers and loan approvals in 2023-24.
4. **Unequal Distribution of Revenue:** Data indicates that states contributing significantly to the GST pool do not always receive a proportionate share in revenue distribution, as the system aims to meet the fiscal needs of all states, including those less developed. This has led to criticism from some prosperous states. For instance, Maharashtra, a top contributor, does not always receive an equivalent share of GST refunds.
5. **Borrowing Restrictions:** States continue to face central government-enforced borrowing caps, which, combined with reduced tax autonomy, can hamper their ability to raise funds, especially during financial crises.

Conceptual framework

The political economy of the Goods and Services Tax (GST) in India functions as a "pooled sovereignty" where both the Centre and states sacrifice exclusive tax powers to create a unified national market. This system oscillates between **cooperative federalism**, characterized by shared decision-making in the GST Council, and **competitive federalism**, where states vie for investment within a standardized tax framework.

1. Cooperative Federalism: The "Pooled Sovereignty"

GST is often cited as the premier example of cooperative federalism because it institutionalizes consultation and consensus.

- **The GST Council:** Established under Article 279A, it is the first constitutional body where the Centre and all states jointly decide on rates, exemptions, and administrative rules.

- **Decision-Making Structure:** Decisions require a 75% majority. The Centre holds 1/3rd of the voting weight, while states collectively hold 2/3rd, ensuring neither can act unilaterally.
- **Fiscal Safety Nets:** The GST Compensation Act, 2017 was a cooperative bargain to guarantee states a 14% annual revenue growth for the first five years, mitigating their fear of financial loss.

2. Competitive Federalism: Performance-Based Rivalry

While GST enforces tax uniformity, it shifts the focus of state competition from "tax wars" to "efficiency wars".

Administrative Efficiency: Since tax rates are uniform, states compete by improving logistics, Ease of Doing Business (BRAP rankings), and digital compliance infrastructure to attract investors.

Reputational Incentives: Organizations like NITI Aayog use delta-rankings and indices (e.g., Export Competitiveness, SDG Index) to drive states to outperform one another in governance and socio-economic outcomes.

Investment Summits: States like Gujarat (Vibrant Gujarat) and Tamil Nadu host global summits to pitch their specific comparative advantages within the national GST architecture.

3. Political Economy Challenges

The transition has also introduced significant friction points that test these federal principles:

- **Erosion of Fiscal Autonomy:** States have lost the power to adjust tax rates to meet local crises, leaving them largely dependent on central transfers and the two remaining revenue sources: liquor and petroleum.
- **The Trust Deficit:** The end of the compensation period in June 2022 and delays during the pandemic created a "trust deficit," with several states (e.g., Kerala, Tamil Nadu, Punjab) demanding extensions due to revenue shortfalls.
- **Judicial Clarity:** In 2022, the Supreme Court ruled that GST Council recommendations are persuasive, not binding, reaffirming that states and the Centre have simultaneous power to legislate, which adds a layer of "contestational federalism".

Feature	Cooperative Aspect	Competitive Aspect
Institution	GST Council (Joint decisions)	NITI Aayog (Performance rankings)
Focus	National uniformity & consensus	State-level innovation & efficiency
Mechanism	3/4th weighted voting	Investment summits & ease of doing business
Goal	One Nation, One Tax	Attracting capital & job creation

Cooperative federalism in practice

In practice, cooperative federalism is the institutional shift from a **top-down** to a **shared-governance** model. While the GST Council is the most visible example, the principle extends across fiscal, administrative, and crisis-management domains.

- a. **Consensus-Based Decisions:** Since its inception in 2017, nearly all major decisions—including rate classifications for thousands of items—have been reached through unanimous consensus rather than formal voting.
- b. **Group of Ministers (GoM):** For complex issues (like taxing online gaming or insurance), the Council delegates research to small groups of ministers from diverse states (e.g., representation from both manufacturing and consuming states) to find a middle ground.
- c. **Unified Administration:** The Goods and Services Tax Network (GSTN) is a jointly owned non-profit that provides a common IT infrastructure for both levels of government, ending separate state-specific tax portals.
- d. **GST Compensation Borrowing:** During the COVID-19 pandemic, when GST collections plummeted, the Centre borrowed **₹2.69 lakh crore** across 2020-22 to pass on to states as back-to-back loans to cover their revenue shortfalls.
- e. **Pandemic Response:** The Disaster Management Act, 2005 was used to coordinate a national response where the Centre provided guidelines and vaccine procurement, while states managed local lockdowns and healthcare infrastructure.
- f. **NITI Aayog:** Replaced the Planning Commission to act as a "think tank" that involves Chief Ministers in national policy design through its Governing Council.
- g. **Finance Commissions:** These bodies, such as the 16th Finance Commission, recommend the vertical sharing of taxes (currently 41% to states) based on objective criteria like forest cover, population, and fiscal performance.
- h. **Centrally Sponsored Schemes (CSS):** Programs like the Swachh Bharat Mission or National Education Policy (NEP) 2020 provide a central vision and funding framework while giving states the flexibility to implement based on local needs.

Competitive federalism under GST

- **Business Reform Action Plan (BRAP):** States are ranked annually based on their implementation of specific business reforms, incentivising them to reduce bureaucratic hurdles.
- **Compliance and Administration:** States like Maharashtra and Uttar Pradesh have leveraged high consumption and efficient tax collection to drive strong revenue growth.
- **Export Preparedness Index:** Ranks states on their ability to support global trade.
- **Sustainable Development Goals (SDG) Index:** Encourages states to align their local spending with global development standards.
- **Vibrant Gujarat** and similar summits in states like Tamil Nadu and Maharashtra focus on sectoral strengths such as Electric Vehicles (EVs) or electronics manufacturing.

- **Policy Experimentation:** States experiment with unique welfare or economic policies, such as Telangana's *Rythu Bandhu*, to create an attractive socio-economic environment.
- **Rate Rationalisation:** The 56th GST Council Meeting (September 2025) approved a move toward a simplified two-slab structure (5% and 18%), which aims to lower compliance costs and help states compete on price competitiveness.
- **Digital Integration:** New initiatives like the **GST analytics hackathon** and enhanced GSTN portal validations aim to improve state-level monitoring and reduce tax evasion.
- **Dispute Resolution:** The Goods and Services Tax Appellate Tribunal (GSTAT) is expected to be fully operational by December 2025, providing a more predictable legal environment for inter-state business

Political Dimensions

The political economy of GST represents a transition from autonomous state fiscal power to a "pooled sovereignty" that fundamentally reshapes the federal balance. Under **cooperative federalism**, the GST Council acts as a constitutional "negotiation table" where the Union and States must reach a 75% consensus, effectively institutionalising a shared-governance model. However, this has birthed a new form of **competitive federalism**; since states can no longer engage in "tax wars" by slashing rates, they must instead compete on **governance quality**, infrastructure, and Ease of Doing Business rankings to attract investment. While the judiciary, via the Mohit Minerals ruling, has protected state sovereignty by declaring Council decisions as "persuasive" rather than binding, the political reality remains one of tension. States increasingly feel a **loss of fiscal autonomy**, often blaming the Centre for revenue shortfalls, while the Union uses the Council's structure to maintain national economic uniformity, making GST a continuous tug-of-war between collective stability and individual state rights.

Judicial perspective

The judicial perspective on GST is defined by the Supreme Court's landmark 2022 ruling in *Union of India vs. Mohit Minerals*. This judgment fundamentally reframed the GST Council's role from a mandatory authority to a **collaborative dialogue** between equal units.

(a). **Persuasive Value:** While the Council is a constitutional body under Article 279A, its decisions hold only "persuasive value". This means states have the constitutional right to deviate from the Council's advice, though they rarely do to maintain market uniformity.

(b). **Simultaneous Power:** The court relied on Article 246A, which gives both the Centre and states equal, simultaneous, and unique powers to make laws on GST. No "repugnancy clause" exists to make central law override state law in this domain.

(c). **Subordinate Legislation:** For the executive branches (the Union and State Governments), the Council's recommendations remain binding when they exercise "rule-making power," such as notifying specific tax rates or exemptions under the existing GST Acts.

(d). **Fair Administration:** In cases like *State of Karnataka v. Ecom Gill Coffee Trading Pvt. Ltd.* (2023), the judiciary emphasized that states cannot use tax enforcement powers (like freezing bank accounts) arbitrarily.

(e). No Double Taxation: The *Mohit Minerals* case itself quashed the levy of IGST on **ocean freight**, ruling it unconstitutional because it amounted to double taxation (as freight was already taxed under customs duty).

CONCLUSION

GST was conceived as a bold experiment in cooperative federalism, but evolving political economy dynamics reveal tension with competitive and centralized federalism. Its long-term success depends on balancing uniform taxation with fiscal autonomy, ensuring that cooperation remains voluntary rather than coerced.

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