

FROM FISCAL FEDERALISM TO FISCAL SUBORDINATION: A CRITICAL ASSESSMENT OF GST'S IMPACT ON THE REVENUE AUTONOMY OF INDIAN STATES

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I. ABSTRACT

This paper critically examines the framework of fiscal federalism and its shift forward, following the introduction of the Goods and Services Tax in India in 2017. The implementation of GST in India has not strengthened cooperative federalism, it has systematically diluted the revenue autonomy and freedom of Indian states, thereby, reducing them from the constitutionally empowered fiscal partners to financially dependent units of the central. It has furthermore deepened the fiscal subordination of the states by the way of dismantling their financial and independent tax base. It further created structural revenue dependency of the state in the centre. And rendering the compensation mechanisms with an efficient, adequate and time-bound substitute for genuine fiscal sovereignty.

The Indian constitution envisages a federal polity where the states retained meaningful control over their fiscal affairs. However, the GST regime, through the abolition of state-level taxes such as the VAT, entry tax and Octroi, fundamentally reframed the balance. This paper critically analyses the Pre and Post GST revenue patterns of Indian states which exposes the structural failings of the GST compensation mechanisms followed by its abrupt cessation in 2022. It further interrogates the functioning of the GST council envisaged as the institution that concentrated on fiscal-decision making powers with the union government. Through an empirical analysis and constitutional scrutiny, this paper further argues that GST has not been just a reformed taxation system, rather a reconfiguration of the federal bargain itself, as a severe cost to the state autonomy.

This paper practically focusses on the variant questions as in 1. Has the implementation of GST structurally dismantled the independent taxation system of the Indian states and to what extent has it replaced the constitutionally guaranteed fiscal autonomy with the dependency on the centralised system? 2. Do Pre-GST and Post-GST patterns of the Indian states empirically establish the promised revenue neutrality of GST or was it a fiscal illusion or just the shift of the class of the biases? 3. Was the GST compensation mechanism a true instrument of fiscal federalism or merely a transitional political concession? 4. Does the structural composition and the decision-making architecture of the GST council reflect cooperative federalism or does it institutionalize the centre dominance with the aim to reduce the states to the role of passive-participation in the fiscal decision-making?

II. GST AND THE STRUCTURAL EROSION OF STATE FISCAL SOVEREIGNTY

When the GST was introduced in India in 2017 July 1. It was celebrated with an extraordinary fanfare. The very special session of the parliament which

was convened by the speeches and the reforms which were held as India's most ambitious pistol shift since independence. The then finance minister described it as a movement of national unity, which was a testament to cooperative

federalism at its roots⁸³. But beneath the celebratory experience, it also laid down a more uncomfortable reality, one that Indian states would begin to confront almost immediately. The Grand promise of cooperative federalism which turned out as a foundation that fundamentally disadvantaged the very partners it claims to empower.

In order to understand what GST is, one must first appreciate what the state possessed before it arrived. Under the constitutional structure which was established by the seven-sister dual and the article 246, Indian states enjoy the reason to believe in an independent tax domain⁸⁴. They could levy value added tax on the sales of goods. At the same time impose entry tax and octroi on goods entering their territories, collect luxury taxes, entertainment tax, and a range of other taxes that together constituted a meaningful fiscal identity. These are not merely revenue streams but they were expressions of constitutional autonomy and freedom. The state government could calibrate this tax policy to reflect local economic conditions, incentivise the industries or generate resources for welfare expenditure without seeking permission from New Delhi. That ability however imperfect was the bedrock of fiscal federalism in India⁸⁵.

GST dismantled this bedrock almost completely through the 101st constitutional amendment of 2016. The parliament and state legislatures granted powers to levy GST, but the operative reality was far more centralising than the constitutional text suggested⁸⁶. States also surrendered the VAT, entry tax, octroi, luxury tax, and other several of the independence levies. Instruments that they had welded for decades in exchange for a share of an unified national taxpool. The quid pro quo, appeared reasonable on paper. In practice, it marked the end of states having independent fiscal actors and the beginning of their existence as revenue-sharing dependents of the union.

The most structurally damaging consequence of this transformation was the elimination of what economists called “own tax buoyancy”, the ability of a state to grow its tax revenues in accordance with the response through its own economic growth⁸⁷. Under the VAT regime, a state that successfully attracted the investment and expanded its manufacturing base, or improved their taxation administration would directly benefit through increased collections. Under GST, this direct linkage was severed. States revenue became a function of national GST collections and the centres became the devolution decisions. Neither of which state could meaningfully influence the other. This shift, subtle in appearance, was seismic in consequence. If reduced state governments from architects of their own fiscal future to passive recipients of centrally determined transfers.

III. HOW THE COMPENSATION MECHANISM FAILED THE INDIAN STATES When states agreed to surrender all of their fiscal independence and fold their tax systems into the GST structure, they did not do so unconditionally. The price of their consent was the GST (compensation to States) Act, 2017. This statutory protection guarantees that the centre would compensate any state whose GST revenue fell short of a projected 14% annual growth rate over the base year of 2015 to 2016⁸⁸. Further the states that were deeply uncertain about surrendering VAT and others who established the revenue resources, this guarantee was the central assurance that made GST politically acceptable to the others. It was in the sense of the federal bargain that the state gave up their freedom and autonomy and received in return a promise of revenue security. That promise was broken not dramatically but incrementally and structurally in ways that exposed the fragility of the entire compensation architecture. The very first rupture came during the time of COVID- 19 pandemic. In 2020-21 GST

⁸³ Ministry of Finance, Government of India, *GST Launch Address by the Hon'ble Finance Minister*, July 1, 2017.

⁸⁴ *Constitution of India*, Art. 246 read with Schedule VII, List II (State List), Entries 52-62.

⁸⁵ M.M. Surya, *Taxation in India: Principles and Practice* (New Delhi: New Century Publications, 2015), pp. 142-148.

⁸⁶ *The Constitution (One Hundred and First Amendment) Act, 2016*, inserting Art. 246A, 269A and 279A.

⁸⁷ National Institute of Public Finance and Policy (NIPFP), *Revenue Implications of GST and Compensation to States* (Working Paper No. 194, 2017), p. 11.

⁸⁸ *The Goods and Services Tax (Compensation to States) Act, 2017*, Section 7.

collections collapsed as economic activity ground to a decrement. The compensation cess fund, which was the designated source for state compensation payment, ran into a severe shortfall⁸⁹ that the centre was legally obligated to cover⁹⁰. This was not cooperative federalism but it was a unilateral reinterpretation of a statutory guarantee at the moment it was needed the most.

Several of the states, particularly those which were governed by non BJP parties, publicly rejected this position and demanded at the centre to fulfil its legal obligation⁹¹. The episode late wore the asymmetry of power within the GST framework, when the fiscal architecture faced degradation, it was the state that absorbed the shock, not the centre that had designed the system.

But the most abrupt damage came not from the pandemic disruption, but from what happened in June 2022, the quiet expiry of the compensation period. The five year guarantee that had been the cornerstone of state consent simply ended there was no extension, no replacement mechanism and no serious National conversation about what came next⁹². States that had restarted their fiscal planning around the compensation guarantee suddenly found themselves exposed. The transition and the ship from a guaranteed revenue flour and structure to completely dependent on the GST collections and revenue, over which States have no independent control and it was abrupt, uncompensated and constitutionally unremedied.

The data that emerged in the post compensation period was telling. States like Punjab, Himachal Pradesh and Uttarakhand, which had been among the highest compensation recipients, reported significant

post 2022 revenue stress⁹³. Their fiscal plans, social expenditure commitments and borrowing programs had all been calibrated against the compensation guarantee. The removal did not only reduce their revenues but also destabilize their entire system.

What the compensation mechanism revealed was the structural contradiction at the heart of the GST federal framework. Reform with permanently altered the constitutional tax relationship between centre and the state which further offered only a temporary and time bound revenue guarantee in return. The permanence of the sacrifice demanded of states was never matched by the permanence of the protection offered to them. When that protection expired, what remained was precisely what these people are used to about GST always moving towards a regime, weird a physical subordination dressed in a language of cooperative federalism⁹⁴.

IV. FROM PARTNER TO DEPENDENCY: CENTRE DOMINANCE, GST COUNCIL AND THE DEATH OF STATE FISCAL AUTONOMY

There is always a particular kind of political deception which operates not through outright falsehood but through careful manipulation of languages. When GST was introduced in India it came up with architectures with reached out for the vocabulary of partnership i.e. "cooperative federalism", "one Nation one tax", "shared sovereignty". These phrases were not only rhetorical flourishment but they were doing serious political work which was persuading 29 state governments to voluntarily surrender all the taxation powers that the constitution had guaranteed to them. In exchange for participation in a new institutional arrangement that was from its very inception structurally weighted against states and towards the centre⁹⁵.

⁸⁹ Comptroller and Auditor General of India, *Report on GST Compensation Cess* (Report No. 2 of 2022), para 3.4

⁹⁰ Ministry of Finance, *Back-to-Back Loan Facility to States in Lieu of GST Compensation*, Press Release, October 23, 2020.

⁹¹ States of Punjab, Kerala and West Bengal formally communicated their rejection of the borrowing option to the GST Council in October 2020. See *GST Council Minutes*, 42nd Meeting, October 5, 2020

⁹² *The Goods and Services Tax (Compensation to States) Act, 2017*, Section 8, compensation period defined as five years from the appointed date i.e. up to June 30, 2022.

⁹³ Reserve Bank of India, *State Finances: A Study of Budgets 2022-23* (Mumbai: RBI, 2023), pp. 67-74.

⁹⁴ Pinaki Chakraborty & Lekha Chakraborty, *Fiscal Federalism in India: Emerging Challenges* (New Delhi: Springer, 2022), pp. 203-211.

⁹⁵ Pratap Bhanu Mehta, *The Burden of Democracy* (New Delhi: Penguin Books, 2003), pp. 89-94; see also M. Govinda Rao, "GST and Cooperative Federalism," *Economic and Political Weekly*, Vol. 52, No. 31 (2017), p. 14

That institutional arrangement was the GST Council. Establishment of the article 279a of the Indian constitution inserted by the 101th Amendment Act of 2016, the GST Council was presented as the supreme federal body which govern the India's unified tax regime⁹⁶. It brought together the union finance minister of chairperson, the union minister of state for finance, and the finance ministers of all the state governments. On the ground reality appears to be an unprecedented experiment in cooperative federalism, a constitutional body where centre and States would deliberately and decide together on matters of taxation. But back on the surface, the voting architecture of the Council told a very different story.

Under article 279A(9), decisions of the GST Council require a three fourth majority of votes cast⁹⁷. The centre holds one third of the total weightage of vote, while all the states together hold two third. This arrangement appeared to be generous to States, until one examines its practical implications and consequences. The centre's one third both share means that it alone can block any decision it disagrees with, since blocking requires more than one fourth of the votes. States collectively holding two third of the vote share, cannot pass any resolution over the centers objection. This voting structure which was dressed up as a federal balance is in reality a centre veto dressed in democratic clothing⁹⁸.

The defenders of The GST Council frequently point out to the fact that it has operated largely on one consensus, with formal voting clearly invoked. This is offered as evidence of cooperative federalism in action. It is proof that the centre and States have worked harmoniously together. But this argument mistaken the absence of open conflict for the presence of genuine equality. Consensus within an institution where one party holds structural

dominance is not an expression of partnership but it is an expression of power⁹⁹.

When the centre controls the agent of the Council, chairs the meetings, provides the secretariat, and possesses all the constitutional Vito overall decisions constitutional veto overall decisions, the consensus, that emergence is inevitably shaped by the shadow of that Power. State start may privately disagree with a proposed rate revision, an exemption decision, compliance requirement phase stark calculus. They can resist loss or they can acquiesce, and maintain a working relationship with the centre upon which they are now fiscally dependent for transport, compensation and borrowing permissions. In this environment where consensus is less of a product of genuine deliberation than a rational responsible structural asymmetry¹⁰⁰.

This dynamic became nakedly visible during the COVID-19 compensation crisis of 2020. When States demanded at the centre full fillet statutory obligation under the GST (compensation to States) Act, 2017, the centre did not bring the matter to the Council for a genuine federal discussion. Instead presented States with two pre determined borrowing options and ask them to choose one between them¹⁰¹. The council which should have been the forum for resolving this federal dispute, became instead the venue for announcing a unilateral Central decision. States which objected like Kerala, Punjab, West Bengal, Telangana, effectively over ruled not through voting but through the political reality that the centre controls the outcome regardless of what the State said¹⁰².

The Supreme Court of India, in *Union of India v. Mohit Minerals Pvt. Ltd.* (2022)¹⁰³, deliver judgement that while primarily concerned with the taxation of ocean freight, content observations of profound importance for the

⁹⁶ *The Constitution (One Hundred and First Amendment) Act, 2016*, inserting Art. 279A into the Constitution of India.

⁹⁷ *Constitution of India*, Art. 279A(9) — votes of the Central Government shall have a weightage of one-third of the total votes cast, and the votes of all State Governments taken together shall have a weightage of two-thirds of the total votes cast

⁹⁸ Nirvikar Singh & T.N. Srinivasan, "Fiscal Policy in India: Lessons and Priorities," in *India's Economic Reforms and Development* (Oxford University Press, 2005), pp. 178-182.

⁹⁹ R. Kavita Rao, *GST in India: An Assessment* (NIPFP Working Paper No. 225, 2018), pp. 8-12.

¹⁰⁰ Pinaki Chakraborty, "Fiscal Federalism Post-GST: Emerging Challenges for States," *Indian Journal of Public Finance and Policy*, Vol. 4, No. 1 (2019), pp. 22-28.

¹⁰¹ Ministry of Finance, Government of India, *Options for States for Meeting the GST Compensation Shortfall*, Press Release, October 2020.

¹⁰² *GST Council Minutes*, 42nd Meeting, October 5, 2020 — dissent recorded by Finance Ministers of Kerala, Punjab, West Bengal and Telangana.

¹⁰³ *Union of India v. Mohit Minerals Pvt. Ltd.*, (2022) 10 SCC 700, para 96-101.

federal character of the GST Council¹⁰⁴. The court held that the recommendations of the GST Council were not binding on either the parliament or the state legislatures. They were merely persuasive in nature. This was a constitutionally important clarification but it simultaneously exposed the paradox at the heart of the council's design. If its recommendations are not binding then States remain in theoretical legislative independence which has no practical reality. But if States exercise that independence by debating from Council recommendation, the risk political and fiscal consequences that the constitutional text does not acknowledge but the political reality enforces its considerable force.

The language of death in this chapter title is deliberately chosen and deliberately defended. Fiscal autonomy does not require a formal constitution Amendment to die, it just requires only that the practical conditions for its exercise be systematically eliminated. Those conditions and independent tax base, meaningful participation and tax policy decisions and protection from centre override and revenue security that does not depend on centre's goodwill, have each been compromised in wearing degrees by the GST regime and the institutional structure of the GST Council.

What remains of state fiscal autonomy after GST is largely formal rather than substantive. States retained legislative power under article 246A, but the power is exercised within parameters set by the centre. They return the powers to administer SGST, but the rates and structure of what the administrator is not their duty to determine. They retain a vote in the Council, but that both cannot overcome the centre's structural dominance. The form of federalism has been preserved but the substance has been surrendered¹⁰⁵.

V. THE WAY FORWARD FOR RESTORING STATE AUTONOMY

The preceding chapters of this paper have established that through constitution analysis,

empirical evidence and institutional critique, the GST has systematically abandoned and eroded the fiscal autonomy of Indian states. What began as a promise of cooperative federalism has crystallized into a structure of fiscal subordination. One where States administer as a text they do not design, earn revenues they cannot independently expand and participate in a Council whose architecture ensures centre dominance at every critical juncture. The tuition that now demands serious scholarly and policy attention is not whether reform is needed. The question is what form that reform must take, and how it must be structured to produce durable federal equity rather than another round of temporary concessions dressed up as a structural change.

This chapter advances concrete, constitutional, grounded and institutionally feasible suggestions across four critical domains, the restructuring of the GST Council, the Restoration of the independent state tax base, the creation of a permanent revenue protection mechanism, and the strengthening of judicial oversight over federal fiscal dispute.

The most foundational reform required in the India GST framework is the reconstitution of the GST Council voting structure. The centre's voting we take must be reduced from one third to a figure that preserves its legitimate interest as a major stakeholder without conferring upon it as an absolute veto¹⁰⁶. A weightage of one fourth, combined with a revised super majority threshold, compares the centre to build genuine coalition among states rather than simply blocking outcomes it dislikes¹⁰⁷. This single structural change would more than any other reform alter The Power dynamics of the Council from dominance to deliberation and discussion. Equally important is the institution independence of the Council secretariat. Currently embedded with the ministry of finance, the councils administrative apparatus is structuralist subordinate to the very executive it

¹⁰⁴ Ibid., para 105; see also Sujit Choudhry, "GST Council and Indian Federalism," *NUJS Law Review*, Vol. 15, No. 2 (2022), pp. 44-49.

¹⁰⁵ Balveer Arora & Niraja Gopal Jayal, *Democracy, Difference and Social Justice* (Oxford University Press, 1999), pp. 312-318

¹⁰⁶ *Constitution of India*, Art. 279A(9); see also R. Kavita Rao, *GST in India: Design and Implementation Challenges* (NIPFP Working Paper No. 225, 2018), pp. 14-17

¹⁰⁷ Pinaki Chakraborty, "Reforming the GST Council for Federal Equity," *Economic and Political Weekly*, Vol. 57, No. 14 (2022), pp. 18-22.

is supposed to check¹⁰⁸. The secretarius must be reconstituted as an independent body¹⁰⁹. It must be stopped autonomously and funded through a dedicated constitutional allocation and answerable to the Council as a whole rather than two an institutional union government. The model offered by the finance commission which operates with institutional independent despite being a constitutional body provides a directly applicable precedent¹¹⁰.

The final and perhaps mostly structural innovation with suggestions advanced by this paper is the establishment of a dedicated federal tax tribunal with constitutional jurisdiction over central-state physical disputes arising from the GST regime. Currently such disputes must navigate the ordinary civil and constitutional litigation structure¹¹¹.

GST has moved India in a wrong direction. It has used the language of unity and efficiency to accomplish a centralisation of fiscal power that the constitution's framers neither intended nor would have endorsed¹¹². Reversing this requires not merely technical adjustments to the tax rate or compensation formula. It requires a fundamental change and recommendation to the principal that Indian states are not administrative subdivisions of the union but constitutionally sovereign partners in a federal enterprise¹¹³. Partners whose fiscal identities must be protected and not near the compensated¹¹⁴.

The reforms proposed here are the beginning of that recovery, not its completion. There implementation could not resolve every tension in India's fiscal federalism framework. Badi would restore to the Indian state something that GST has taken from them, the constitutional dignity of fiscal partnership¹¹⁵.

VI. CONCLUSION

The Indian constitution envisioned federal polity, not a unitary state wearing federalism colours. It

distributed legislative and fiscal power balance between the centre and state within deliberative care. It recognised that meaningful autonomy at the sub-National level was not merely an administrative convenience Bata constitutional guarantee. GST has quietly but consequentially disturbed this guarantee.

This paper has demonstrated across four critical dimensions that GST has transformed the Indian states from constitutionally empowered fiscal patterns into structural dependent revenue sharing units. The elimination of independent state tax and the centre dominate architecture of the GST Council along with the catastrophic period of the compensation scheme and the empirical evidence of post GST revenue stress collectively confirm that the paper title asserted from the outset that India has moved from fiscal federalism toward fiscal subordination.

What makes transformation particularly concerning is the permanence. States surrender their independent text base irrevocably. The compensation they received in return was temporary. The voting architecture that disadvantages them in the GST Council requires a constitution Amendment to correct. The fiscal dependency that had resulted is not a transitional inconvenience but it is a structural condition that will deepen with time unless deliberately reversed.

The reforms suggested in the preceding chapter, restructuring the GST Council, restoring a limited independent tax base, creating a permanent revenue equalisation mechanism, and establishing a federal tax tribunal, are not radical propositions. They are constitutionally grounded corrections to a regime that has drifted too far from its federal foundation.

Indian federalism has survived considerable stress in 1950. But survival is not the same as flourishing. If GST's promise of cooperative

¹⁰⁸ Finance Commission of India, *Fifteenth Finance Commission Report* (2021), Vol. I, para 2.12 — on institutional independence of federal fiscal bodies.

¹⁰⁹ Reserve Bank of India, *State Finances: A Study of Budgets 2022-23* (Mumbai: RBI, 2023), pp. 45-52.

¹¹⁰ National Institute of Public Finance and Policy, *Petroleum Taxation and Federal Finance in India* (Working Paper No. 267, 2020), pp. 11-16.

¹¹¹ Justice B.N. Srikrishna Committee Report on Data Protection and Federal Institutions (2018) — on specialist tribunal design in Indian constitutional framework, para 12.4.

¹¹² T.R. Andhyarujina, *Constitutional Questions and Citizens' Rights* (Oxford University Press, 2011), pp. 201-206.

¹¹³ Granville Austin, *The Indian Constitution: Cornerstone of a Nation* (Oxford University Press, 1966), pp. 186-192.

¹¹⁴ B.R. Ambedkar, Constituent Assembly Debates, Vol. VII, November 4, 1948 — on the federal character of the Indian Constitution and the sovereignty of states within their domain.

¹¹⁵ K.C. Wheare, *Federal Government* (4th ed., Oxford University Press, 1963), pp. 93-97 — on the conditions necessary for genuine fiscal federalism.



federalism is to mean anything beyond political rhetoric, the structure and the corrections in this paper advocates must move from academic suggestions to legislative reality.

