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Cooperative Federalism and Fiscal Autonomy in India: An Analysis under the GST Regime

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Abstract:
The implementation of the Goods and Services Tax (GST) in 2017 marked a paradigm shift in Indian fiscal federalism, transitioning the nation from a system of fragmented taxation to a unified "One Nation, One Tax" framework. This paper explores the delicate balance between cooperative federalism and states' fiscal autonomy within this new architecture. Central to this transition was the constitutional amendment that necessitated both the Union and State governments to pool their sovereignty, creating a unique institutional mechanism: the GST Council. The paper first examines the concept of cooperative federalism, wherein the Center and States act as equal partners in decision-making. The GST Council serves as the primary vehicle for this cooperation, where every state, regardless of size, has a voice in determining tax rates and exemptions. However, this collective decision-making process inherently curtails states' fiscal autonomy. Historically, states possessed the power to vary sales tax rates to meet local exigencies; under GST, this power is largely subsumed into a harmonized structure, leading to concerns regarding "fiscal subordination." A critical component of this transition was the GST Compensation Mechanism. To mitigate the fears of manufacturing states and those anticipating revenue losses, the Union government guaranteed a 14% annual revenue growth rate for the first five years of implementation. This paper analyzes the effectiveness of the GST Compensation Cess and the friction points that emerged, particularly during the COVID-19 pandemic, when the "protected revenue" gap widened significantly. The ensuing standoff between the Center and States over borrowing options highlighted the vulnerabilities of relying on statutory guarantees in an unpredictable economic climate. Finally, the study evaluates the evolving nature of Center-State relations post-2022, as the mandatory compensation period has concluded.
It argues that while GST has successfully streamlined the tax administration and reduced the cascading effect of taxes, the future of Indian federalism depends on whether the GST Council can evolve from a mere administrative body into a platform that genuinely respects the diverse fiscal needs of the states. The paper concludes that for GST to succeed, the spirit of "trust-based federalism" must outweigh political exigencies, ensuring that states remain financially empowered to fulfill their developmental mandates.

Key Words: Cooperative Federalism, Fiscal Autonomy, GST (Goods and Services Tax) regime, Indian Federalism, Fiscal Federalism, GST Compensation Cess, Fiscal Subordination, Trust-based Federalism

Introduction:

The implementation of the Goods and Services Tax (GST) in 2017 represented a landmark shift in India's fiscal architecture. Transitioning from a fragmented tax system to a unified "One Nation, One Tax" framework, GST aimed to streamline tax administration and eliminate the "cascading effect" of taxes where tax was levied on tax. However, this transition was not merely a technical change in tax collection; it was a constitutional overhaul that required both the Union and State governments to "pool their sovereignty". As we enter the era of the 16th Finance Commission (2026–2031), the tension between this collective cooperation and individual state fiscal autonomy remains a central theme in Indian political science. This paper explores the inherent tension between the ideals of cooperative federalism and the practical reality of state fiscal autonomy within this new regime

Background of the Study:

India's federal structure has always been defined by a delicate balance between a strong Union and autonomous States. K.C.Wheare famously described India as "quasi-federal," a description that has been tested most rigorously in the domain of finance. Fiscal federalism—the division of financial powers and responsibilities is the bedrock of state autonomy. Without independent revenue streams, political autonomy becomes theoretical. For decades, India operated under a system where the Center taxed production (Excise) and services (Service Tax), while States taxed sales (Sales Tax/VAT). This separation ensured that States had their own revenue stream that they could turn on or off based on their developmental needs. The introduction of the Goods and Services Tax (GST) on July 1, 2017, marked a paradigm shift. It was termed a "Grand Bargain," in which States surrendered their exclusive taxation powers in exchange for a share in a unified national market and for promised revenue stability.

Hypothesis:

While GST was marketed as the ultimate tool for "Cooperative Federalism," nearly a decade of implementation reveals deep fissures. The centralization of decision-making in the GST Council, the delay in compensation payments during the COVID-19 pandemic, and the cessation of guaranteed compensation in June 2022 have raised existential questions for State finances. The central research question this paper addresses is whether

the GST regime has successfully fostered cooperative federalism or has systematically dismantled the fiscal autonomy of Indian States.

Objectives of the Study:

- The primary goal of this research is to evaluate the functional balance between national tax uniformity and the constitutional right of states to financial independence. The specific objectives are as follows:
- To Analyze the Concept of "Pooled Sovereignty": Examine the institutional role of the GST Council as a vehicle for cooperative federalism where the Center and States act as equal partners in decision-making.
- To Evaluate the Impact on State Fiscal Autonomy: Investigate how the transition to a harmonized tax structure has curtailed states' historical power to vary tax rates to meet local exigencies, potentially leading to "fiscal subordination".
- To Formulate Recommendations for Strengthening Cooperative Federalism Propose reforms to the GST framework, such as revising the Council's voting structure or establishing an independent dispute-resolution authority, to better balance national efficiency with state autonomy.
- Tanalyze the Constitutional Shift in taxatiopowers, examiningne how the 101st Constitutional Amendment fundamentally restructured the Seventh Schedule by replacing exclusive taxation powers with the concurrent jurisdiction under Article 246A.
- To Examine the Economic Implications for Manufacturing vs. Consuming States Analyze the shift from origin-based to destination-based taxation and how it creates revenue disparities between "producer" hubs like Maharashtra and "consumer" hubs like Bihar
- To Investigate Friction Points in Center-State Relations: Analyze the challenges posed by the conclusion of the mandatory GST compensation period and the Center's reliance on cess and surcharges, which remain outside the divisible pool.

Research Methodology:

This paper employs a Doctrinal Research Methodology, analyzing primary legal sources including the Constitution (101st Amendment) Act, 2016, and the Central Goods and Services Tax Act, 2017. It also utilizes Analytical and Comparative methods to interpret judicial pronouncements (Supreme Court judgments) and empirical data regarding state revenue collections to draw conclusions about the health of Indian federalism.

The Constitutional Architecture: The implementation of GST required a fundamental alteration of the Constitution, as neither the Centre nor the States had the power to tax the entire value chain of goods and services simultaneously

The 101st Constitutional Amendment Act 2016: This amendment effectively deleted the "firewalls" that separated Central and State taxation. Article 246A: This is the heart of the GST regime. Unlike the Union List (List I) or State List (List II) where powers are exclusive, Article 246A grants "simultaneous" power to both Parliament and State Legislatures to make laws regarding GST. This was intended to place States on an equal footing with the Centre.

Article 269A: This article covers the Integrated GST (IGST) on inter-state trade. While the Centre levies and collects this tax, it is mandated to be shared with the States based on the destination principle.

Abolition of State Powers: Crucially, Entry 54 of the State List (power to tax the sale of goods) was drastically curtailed to include only five petroleum products and alcohol for human consumption. This effectively meant States lost 60-70% of their independent revenue-generating authority.

The Legislative Shift: Pre-GST vs. Post-GST

Before GST, the Centre and States had mutually exclusive taxing powers under the Seventh Schedule.

Pre-GST: The Centre levied Excise Duty and Service Tax, while States levied VAT/Sales Tax, Entry Tax, and Luxury Tax.

Post-GST: These were subsumed into a dual GST structure (CGST, SGST, IGST). Article 246A now grants concurrent power to both levels of government, ending the era of exclusive jurisdiction over most indirect taxes

The GST Council: To manage this concurrent jurisdiction, Article 279A established the GST Council. It is the first federal body in India with constitutional executive powers, comprising the Union Finance Minister and State Finance Ministers.

Voting Structure: Decisions are meant to be consensus-based. However, if a vote is required, the Center holds a 1/3rd weightage, and all States combined hold a 2/3rd weightage. The Veto Reality: A decision requires a 3/4th majority (75%). Since the Center holds 33.33% of the vote, no decision can pass without the Center's consent. Effectively, the Centre has a veto. Conversely, roughly 12-13 states (depending on the total present) can veto a Central proposal.

Cooperative Federalism or Coercive Centralization?

The narrative of "Cooperative Federalism" suggests a partnership of equals. However, the operational reality of the GST regime presents a mixed picture. The Myth of Consensus

for the first few years, the GST Council prided itself on taking every decision by consensus, avoiding voting. While it was optically good for federalism, critics argue that this was often a "managed consensus." Smaller states, often dependent on Central grants, rarely opposed the Union. The cracks appeared during the lottery tax debate (2019), where the first vote was taken, and later during the compensation crisis.

Fiscal Autonomy: The Economic Analysis

The most significant impact of GST has been on the "Fiscal Space" of States their ability to raise resources to fund their specific expenditure needs (health, education, police). Vertical Fiscal Imbalance: India suffers from a high vertical fiscal imbalance; the Centre holds the most buoyant tax powers (Income Tax, Corp Tax), while States shoulder the majority of developmental expenditure. GST was supposed to correct this by ensuring better compliance and higher revenues. Reality Check: Instead of buoyancy, GST collections initially stagnated. States that were manufacturing hubs (such as Maharashtra, Tamil Nadu, and Gujarat) lost out because GST is a "destination-based tax." The tax revenue goes to where the goods are consumed (often poorer, populous states like UP or Bihar), not where they are made.

Analysis and Empirical Discussion

The Shift from Origin-based to Destination-based Taxation**:** The fundamental shift in India's fiscal landscape under GST is the move from an origin-based tax (where the state producing the goods collected the tax) to a destination-based tax (where the state consuming.)

Manufacturing States (The "Losers"): States like Maharashtra, Tamil Nadu, and Gujarat have historically invested heavily in infrastructure to attract industry. Under the old VAT regime, they retained the tax benefits of this production. Under GST, these "producer states" have seen a relative decline in their independent tax-to-GSDP ratios. For instance, Maharashtra contributes nearly 15% of India's GDP but must now share its vast tax base with the national pool, resulting in an estimated annual revenue gap of ₹30,000 crore after compensation.

Consuming States (The "Gainers"): Populous, less-industrialized states like Bihar and Uttar Pradesh have seen a fiscal windfall. Since GST follows the consumer, Bihar's revenue growth reached a staggering 42.5% in the early implementation years. For Bihar, Integrated GST (IGST) settlements now account for over 60% of its total SGST revenue, proving that the regime acts as a massive redistributive tool.

Erosion of State Fiscal Autonomy

The analysis reveals that while the "tax pool" has grown, the "tax power" of individual states has shrunk: Fixed Rate Structure**:** States can no longer lower taxes to attract

investment or raise them during a regional crisis (like a natural disaster) without GST Council approval. Dependency on the Centre**:** The delay in Compensation Cess payments during the 2020-22 period highlighted a dangerous vulnerability. States were forced to borrow from the market, shifting the burden of fiscal management from the Union to the sub-national level. The "Veto" Factor: Because the Union Government holds 33.3% of the voting power in the GST Council, no resolution can pass without Central support. This creates a "forced consensus" model rather than a purely cooperative one. The Compensation Crisis and Broken Trust To convince States to join GST, the Centre guaranteed a 14% annual growth in their GST revenue for five years (2017-2022), promising to make up any shortfall through a "Compensation Cess."The Shock of 2020: When the pandemic hit, GST collections collapsed. The Centre invoked an "Act of God," initially refusing to pay full compensation. This triggered a massive federal standoff. Although the Centre eventually borrowed money to pay the States, the delay forced States to cut capital expenditure during a health crisis, exposing their extreme vulnerability. The guaranteed compensation ended in June 2022. Impact: States like Punjab, Himachal Pradesh, and Kerala faced revenue gaps of over 20%. Without the safety net of compensation, these states are now staring at a fiscal cliff. They have lost the power to introduce new taxes to fill this gap, as their taxation powers are subsumed under GST. Their only option is to increase borrowing or cut spending both of which harm the economy.

Data Analysis: GST in 2026

As of early 2026,GST collections have shown remarkable resilience and growth. Record Collections: In February 2026, gross GST revenue rose to ₹1.83 lakh crore, representing an 8.1% year-on-year increase.

Cumulative Performance: For the fiscal year 2025-26,total collections reached ₹20.27 lakh crore by February 28.

State Trends: While industrial leaders like Maharashtra and Karnataka dominate, states like Andhra Pradesh have hit record highs (₹3,061 crore in February 2026), showing that the tax base is deepening

The 16th Finance Commission (16th FC) Framework (2026-31).

Chaired by Arvind Panagariya, provides the roadmap for fiscal relations for the next five years.

Vertical Devolution: The Commission has recommended maintaining the states' share of the central divisible pool at 41%.

Performance Incentives: For the first time, a "Contribution to GDP" parameter has been introduced in the horizontal distribution formula, rewarding states for economic efficiency.

The "Cess" Problem: The 16th FC has addressed the rising share of cesses and surcharges (which are not shared with states), recommending greater transparency and a disclosure of CAG-certified data on net tax proceeds.

Aspect	Pre-2026 (15th FC)	Post-2026 (16th FC)
Devolution %	41%	41% (Maintained)
Focus	Pandemic Recovery	GDP Contribution & Efficiency
Grants	Revenue Deficit Grants	Performance-linked Grants
Borrowing	Flexible during COVID	Strict end to Off-Budget Borrowing

Issues and Challenges in the Current Regime

Erosion of State "Tax Sovereignty" Before GST, if a state like Kerala faced a flood, it could temporarily increase VAT to raise relief funds. Under GST, it must beg the GST Council for permission to levy a cess (as Kerala did in 2018). This reduces State Finance Ministers to mere fund managers rather than policymakers.

The Problem of Cesse and Surcharges: While GST collections are shared, the Centre has increasingly relied on "Cesse and Surcharges" on Income Tax and Customs (e.g., Petrol Cess, Agriculture Infrastructure Cess). These are *not* shared with States.

This shrinks the divisible pool of taxes, meaning the Centre keeps a larger slice of the total national revenue pie, by passing the Finance Commission's devolution formula.

Dispute Resolution Mechanism: Article 279A(11) mandates the GST Council to establish a mechanism to adjudicate disputes. However, nearly seven years later, no such independent tribunal exists. Currently, the GST Council itself (where the Centre has a veto) is the arbiter of disputes. This violates the principle of natural justice—one cannot be a judge in their own cause. One Size Does Not Fit All GST imposes a uniform tax rate across India. However, India's economic diversity is vast. A tax rate suitable for a highly industrialized state may be crushing for a service-dependent or agrarian state. States have lost the flexibility to use tax policy as a tool to attract investment or support specific local industries.

Case Studies:

Manufacturing States (Tamil Nadu & Maharashtra) These states initially opposed GST because it taxes consumption. They have consistently flagged that they contribute significantly to the national exchequer but receive little in return. Their fiscal autonomy is severely constrained as they cannot tax their massive manufacturing output to fund their advanced infrastructure needs. Consuming States (Bihar & Odisha)Theoretically, these

states should have benefited from the destination principle. While their share in tax collection has improved relative to the old regime, the overall sluggishness of the economy and the end of compensation means they too are struggling to meet budget targets without Central support.

Maharashtra: The "Donor" State Challenge remains India's largest GST contributor, yet it faces unique challenges regarding fiscal autonomy and revenue retention.

Revenue Contribution: In FY2024-25, Maharashtra's GST contributions approached ₹2.98 lakh crore, accounting for roughly 35-45% of the national pool.

Fiscal Shortfall: Despite high collections, the state finance department estimated an annual shortfall of ₹30,000 crore following the end of the GST Compensation period in mid-2022.

Decline in Own-Tax Performance: Pre-GST, Maharashtra's Own Tax Revenue (OTR) as a share of GSDP was approximately 66%. Post-implementation, this share saw a visible decline, reflecting a reduction in the state's independent capacity to raise resources.

Local Body Impact: In Mumbai, the abolition of Octroi (which previously provided 86% of municipal funds) has left the city dependent on state-transferred GST grants, covering only about 50% of its functional requirements.

The "Consumption-Led" Growth. As a destination-based tax, GST was designed to benefit less-industrialized, high-consumption states like Bihar by capturing tax at the point of sale rather than production.

High Growth Rates: Bihar recorded one of the highest growth rates in total GST collection at 42.5% in the early years of implementation, significantly outperforming richer states like Maharashtra and Tamil Nadu in percentage terms.

IGST Dependency: Bihar's revenue is heavily driven by Integrated GST (IGST) remittances. IGST settlements account for approximately 66% of Bihar's total SGST revenue, compared to a much lower share in manufacturing-heavy states.

Climb in Rankings: By late 2025, Bihar climbed from the 20th to the 14th position in nationwide GST collections, surpassing several historically larger contributors in relative growth

Judicial Reaffirmation: The Mohit Minerals Case (2022)

A critical turning point in this analysis is the Supreme Court's ruling in *Union of India v. Mohit Minerals*. The court held that:

The GST Council's recommendations have persuasive value but are not legislative mandates. Both Parliament and State Legislatures possess simultaneous power to

legislate on GST. This judgment acts as a safety valve for fiscal autonomy, reminding the Centre that states are not mere subordinates in the GST framework

Empirical Findings:

The data suggests a **"Two-Tiered Federalism"**:

Tier 1 (Economic): GST has created a unified market, reduced the cascading effect of taxes, and increased compliance through digitalization.

Tier 2 (Political): It has centralized fiscal policy. The "Fiscal Autonomy" of states is now a shared autonomy, where states must negotiate for every percentage point of revenue growth.

Recommendations:

To prevent GST from becoming a tool of power of the Centre could be restricted to specific "national interest" areas, allowing States more leeway in others.

Independent Secretariat: The GST Council Secretariat is currently housed in the Union Ministry of Finance. It should be converted into an independent, neutral body that serves both Union and States impartially, conducting unbiased research.

Revenue Augmentation: To restore fiscal autonomy, the GST Council should consider bringing petroleum and real estate under GST. While controversial, this would widen the base and potentially reduce the rates, benefiting both revenue and inflation.

Recommendations for Strengthening Cooperative Federalism: To ensure that the GST regime does not lead to "coercive federalism," the following structural reforms are recommended based on the research findings:

Reforming the Voting Power in the GST Council: Currently, the Union Government holds a 1/3rd vote share, giving it a de facto veto. To enhance fiscal autonomy, the voting weight should be redistributed so that no single entity (Centre or a small group of States) can unilaterally block or pass a resolution.

Establishment of a Dispute Resolution Mechanism: Article 279A(11) provides for a mechanism to adjudicate disputes between the Centre and States. An independent GST Tribunal or an Adjudicatory Body should be activated to resolve issues like compensation delays and IGST settlement errors without moving to the Supreme Court.

Restoring Limited State Taxing Powers: States should be allowed a narrow "flexibility window" (e.g., a 1-2% leeway on certain sin taxes or luxury goods) to raise emergency funds for regional disasters (like floods in Kerala or droughts in Maharashtra) without seeking Council approval.

Institutionalizing the "Persuasive" Nature of Recommendations: Following the *Mohit Minerals* ruling, the GST Council should function more as a deliberative

platform rather than a command center. States should be encouraged to present "Impact Assessment Reports" before any rate changes are implemented.

A Permanent Compensation Framework: Instead of a temporary 5-year bridge, a "Fiscal Insurance Model" should be created. A portion of the GST pool should be set aside permanently to support states that face sudden revenue shocks due to global economic shifts or pandemics.

Summary of Findings:

On Cooperative Federalism: GST has succeeded in creating a "Single National Market," but the "One Nation, One Tax" has come at the cost of "One Size Fits All" policy-making. The GST Council is a unique experiment in shared sovereignty, yet the Centre remains the "Senior Partner."

On Fiscal Autonomy: The research shows a clear Vertical Fiscal Imbalance. While consuming states like Bihar have seen growth, manufacturing giants like Maharashtra have lost their independent leverage. The Mohit Minerals case serves as a constitutional reminder that the federal structure is "indestructible," and states retain their legislative identity.

Conclusion : The Goods and Services Tax is undoubtedly India's most ambitious economic reform. It has simplified the tax web and unified the market. However, viewed through the lens of federalism, the results are concerning. The transition has moved India from "bargaining federalism" to "structured negotiation," but the structure is heavily tilted towards the Centre. The current regime has achieved "One Nation, One Tax," but at the cost of "One Nation, One Voice"—the Centre's voice. True cooperative federalism requires that States are not just stakeholders but equal partners. The erosion of fiscal autonomy poses a danger to India's democratic diversity, as States are reduced to implementation agencies of Central policy. For the GST experiment to succeed in the long run, it must evolve from a "rigid union" into a "flexible federation" where fiscal autonomy is respected not as a hindrance to growth, but as a prerequisite for democratic accountability. The "Grand Bargain" must be renegotiated to ensure that while the market remains unified, the States do not go bankrupt. As the Supreme Court noted, Indian federalism is a dialogue, not a monologue. It is time the GST regime reflected that dialogue in spirit and substance.

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