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GST Reforms and Rural Livelihoods in India: A Theoretical Reassessment through the Canons of Taxation

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Abstract

The Goods and Services Tax (GST) that was announced in 2016 and implemented in 2017 was considered the biggest reform in which India's fragmented indirect tax system was consolidated under one umbrella into a destination-based value-added system. While it is nothing if not efficient and simple, one can only speculate as to what three- or four-letter string will emerge from its impact on rural livelihoods. This paper reconsiders GST in terms of Adam Smith's classical canons of taxation (equity, certainty, convenience, and economy) using the analytical framework elaborated in the base structure.

The analysis exposes a discrepancy between the design of GST in theory and the implementation of GST in rural and informal sectors. Digital limitations, a compliance burden, and poor awareness hinder the fulfillment of canonical principles particularly among small producers and households. The paper also analyses GST 2.0 reforms, Centre-State fiscal relations and rural capital expenditure and tax revenue mismatch.

With the inclusion of behavioural responses to taxation, the research illustrates how complexity and perceived unfairness deter compliance and push players into informality. The Polavaram project case demonstrates how fiscal slippages are translated into real economic costs. In the concluding section of the paper, to make GST more inclusive and for it to be attuned with the objectives of Viksit Bharat 2047, selective reforms based on the nature of activities and commodities or services, and regions.

Keywords: Goods and Services Tax (GST), rural livelihoods, canons of taxation, tax equity, fiscal federalism, informal sector, compliance burden, digital divide, tax morale, rural economy, public expenditure, Polavaram Project, and Viksit Bharat 2047.

1. Introduction

Taxation is not only a revenue tool but also an instrument for promoting economic efficiency, equity, and welfare. For a structurally complex economy such as India, it also significantly influences production, consumption and income distribution. The advent of GST was a shift away from a fragmented and cascading tax regime to a comprehensive value-added system. GST subsumed a number of indirect taxes with the objective of minimizing distortions in the tax system, enhancing compliance and ensuring the integrity of national markets. These ends have, at least for the formal sector, been substantially achieved via better logistics, more fluid interstate commerce, and improved flows of input tax credit.

But the informal economy-based rural India, which accounts for more than 65% of the population, meets its own set of tribulations. Digital infrastructure is modest, financial literacy low, and income patterns irregular – factors that hamper both rural households and small businesses in meeting GST demands.

This raises a fundamental question: Is GST in alignment with the requisites of a perfect taxation system by rural livelihoods standards?

The paper draws on Adam Smith's four canons of taxation as the analytical lens, as well as behaviourial and federal considerations. It also looks at the relationship between tax revenue and capital expenditure and raises concerns about rural spending.

Including the Polavaram irrigation scheme adds a realistic dimension of how financial and bureaucratic considerations impact on rural development results. The paper makes the case, in the end, that the measure of GST success should not be just in terms of efficiency gains but also in terms of whether it contributes to inclusive growth.

2. Classical Theory of Taxation: Foundation of Modern Fiscal Systems

Adam Smith, in The Wealth of Nations, set out the four maxims of taxation which still form the basis of today's tax systems. These remain a good standard for measuring tax design and performance, albeit in economies that are structurally unequal.

2.1 The Four Canons

Equity: The taxation should be based on the ability to pay. In indirect taxation system it is in the form of differentiated tax rates for essential goods and luxury goods.In direct taxation it is through rebates for essential commodities.Complete the following tables highlighting differences between direct and indirect taxation. But consumption taxes are regressive and so take a disproportionate share of income from the poor.

Certainty: It should be clear, predictable and transparent what the tax duties are. Sudden shifts in rates or classifications may stir up uncertainty and inhibit business.

Convenience: The taxation should be levied at a time and in a manner convenient to the source of income. Although digital services enhance convenience for some, they also present challenges for individuals with limited access to technology in other areas.

Economy: The cost of collecting taxes and of complying with them ought to be kept as low as possible. Compliance costs that are too high can impair efficiency, particularly in small businesses.

2.2 Economic Significance

These canons are baselines for an effective taxation system that is efficient and equitable and promotes compliance. When these are not fulfilled, agents tend to move to informality, andTaxes efficiency is undermined. In the context of GST, these principles serve as valuable prisms through which to assess whether the reform meets or exceeds its objectives in both the formal and rural economy.

3. GST and Classical Tax Canons Fulfilled

Conceptually, GST was to fit neatly within classical tax principles. But, that's for those principles to be set against and how those principles work in practice, especially in rural.

3.1 Equity

GST follows a multi-slabs tax structure based on the ability to pay principle. Goods such as fresh food, milk, vegetables are exempt(0%) except any basic need goods under 5% slab. Normal goods and services are subject to a 12%-18% tax, while they are subject to a 28% tax with an additional cess for luxury or sin products.

Claiming this structure indirectly upholds vertical equity by shifting a smaller share of tax burden upon low-income families. However, GST is still a regressive tax, i.e. it has remained a pure consumption tax. As rural families spend more of their income on consumption, they endure a relatively higher effective tax burden.

Compressed margins and income volatility For small rural producers, weak pricing power means they can scarcely pass on tax charges to end-consumers. Consequently, GST satisfies fairness in design, but its distributional effect is uneven.

3.2 Certainty

The GST subsumed the entire gamut of local and State level taxes into one comprehensive tax, thereby improving transparency and reducing complications. The "One Nation, One Tax" system was supposed to give certainty in tax liability and help in long term planning.

But undercutting these reassurance, frequent cambio in rate, contention over classification and challenges such as inverted duty structures have generated uncertainty, especially for MSMEs and rural traders. This uncertainty increases the compliance risk for small firms with low access to advice and discourages formalization.

3.3 Convenience

GST is a big digital push with registration, filing and payments all being done online on the GST Network (GSTN). This has allowed formal, urban businesses to be more efficient and spend less time on transactions.

But in the countryside, convenience is limited by poor access to the internet, low digital literacy and reliance on intermediaries. Compliance frequently demands external support, adding to both expense and complexity. Therefore, a system created for convenience may become a barrier in situations of digital inequality.

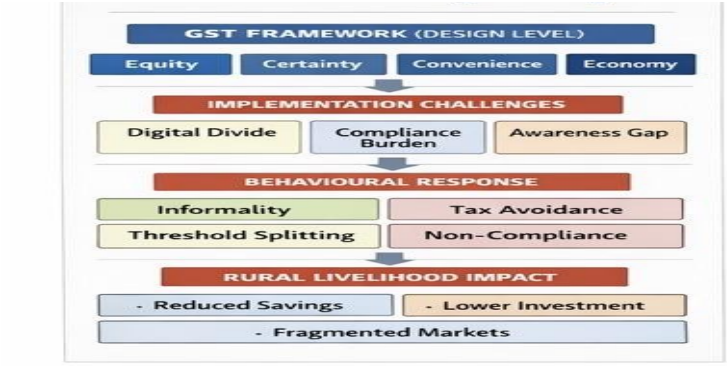
3.4 Economy

The GST has contributed to greater economic efficiency, by removing cascading taxes and simplifying supply chains. Lower logistics costs and quicker flow of goods have favoured organised sectors.

That said, the costs of compliance are still high for small business. The fees for accountants, return filing, e-way bills, and books upkeep are disproportionately levied on small businesses. This weakens the principle of economy - particularly in rural areas, where administrative infrastructure is minimal.

Although GST is aligned with classical canons in principle, its application shows large voids in rural and informal spaces. The gap between design and experience is, therefore, the defining concern for its inclusiveness.

Figure 1: GST Design vs. Rural Reality Gap



Source: *Author's conceptual framework.*

4. **GST Rate Slabs (Old vs Revised) & GST 2.0**

4.1 A Evolution of Structure

The GST regime introduced in 2017 adopted five slabs – 0%, 5%, 12%, 18%, 28% and a special cess on some particular luxury and sin products. Gradual rationalisation of structure has taken place over time.

A number of goods have also been shifted between slabs to simplify the structure, with the 28% slab now almost exclusively reserved for luxury goods. The 18% slab is still the standard rate under which most goods and services fall.

Table 1: GST Rate Structure – Old vs. Revised

GST Rate	Old Structure (2017)	Revised / Current Structure
0% (Exempt)	Fresh food, milk, fruits, vegetables	Largely unchanged
5%	Basic necessities, transport services	Continued with minor revisions
12%	Processed goods, fertilizers	Many items shifted to 5% or 18%
18%	Majority of goods & services	Remains the dominant slab
28%	Luxury goods, consumer durables	Restricted to luxury & sin goods
Cess	On luxury/sin goods	Continues selectively

Source: *Compiled by the author based on Goods and Services Tax Council notifications and Ministry of Finance publications.*

Notwithstanding rationalisation, multiple slabs still pose classification issues and the problem is even greater for tiny businesses.

4.2 GST 2.0: Reforms and Evolution in Structures

The GST 2.0 represents the continuing drive to simplify and fortify the tax system. The reform roadmap is articulated around three key pillars:

4.3 Rationalising tax slabs:

The trend is to reduce the slabs maybe merging into a simple 3-tier structure that is too plain to be true. It would lessen the classification problems and increase predictability.

4.4 Technological Integration:

The increased utilization of e-invoicing, data analytics and automated compliance system is likely to improve transparency and minimize tax evasion. But it is causing a few worries about whether it will be user-friendly for small and rural taxpayers.

4.5 Broadening of Tax Base:

Attempts are being made to bring additional MSMEs in to the unorganised fold by way of simplified schemes and raising thresholds.

While reform efforts in this area are welcome, they are not without challenges. Procedures are still complicated and need constant updating, and small business owners and rural locals still have difficulties.

5. Taxation, Behaviour, and the Rural Livelihoods

At the theoretical level, when linked to realities on the ground, taxation affects outputs in the economy and is determinant of behavioural outcomes. Where tax systems violate the principles of horizontal equity, or certainty, or convenience, they create incentives that could lead to informality.

5.1 Behavioural Consequences

Two major behavioural responses are observed that emerge in relation to increasing complexity and cost of compliance of tax systems:

1. Decreased formal participation: Many small businesses consciously stay under the GST thresholds or fragment their businesses.
2. Rising informality and evasion: Too high costs of compliance and excessive uncertainty promote "off the books" deals.

These changes suggest that from a tax perspective, compliance is not simply a legal issue but also a behavioural one, and that fairness and the ability to participate informally matter.

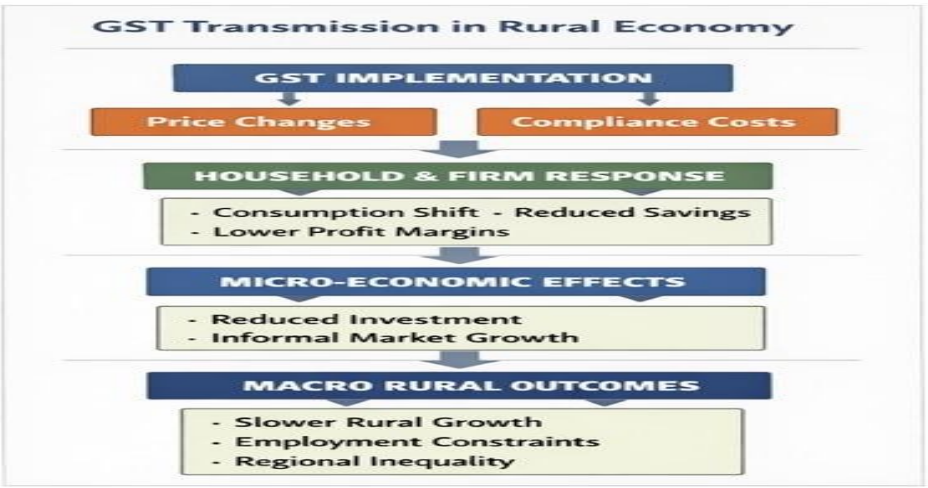
5.2 Effect on the rural economy

Savings: Through Increasing the Cost of Consumption and Reducing Discretionary Income, Indirection Taxation Reduces the Saving of Rural Households.

Investment: Tax rate uncertainty and compliance hinder the growth of micro-enterprises and impede capital formation.

Consumption: The consumers generally prefer going to the informal market to purchase the goods where GST is not levied and this causes two supply side problems, viz. The informal [market] is more fragmented and is also weakening formal supply chains.

Figure 2: GST Transmission Mechanism in the Rural Economy



Source: *Author's conceptual framework.*

5.3 Challenges faced

Rural residents filing taxes face three structural barriers:

1. Awareness gap: Limited knowledge about GST rules and benefits
2. Digital divide – limited availability of internet services and digital devices
3. Heavy compliance burden: Disproportionate for small businesses that generate low revenue

"A tax system that is theoretically sound but behaviourally misaligned risks exclusion. To overlook rural realities is to erode both equity and convenience, and to cap the effectiveness of GST."

6. Effect of Taxation on Production

i. Ability to work, save, and invest:

The imposition of GST, through compliance costs, procedural requirements, and administrative frictions, effectively reduces the net investible surplus of micro, small, and informal enterprises. This erosion of retained earnings constrains capital formation, limits reinvestment in productive assets, and weakens the long-term expansion capacity of small producers.

ii. Desire to work, save, and invest:

Increased regulatory complexity, documentation burdens, and perceived asymmetries in tax incidence dampen entrepreneurial motivation, particularly within informal and semi-formal sectors. These frictions reduce the marginal propensity to invest and distort intertemporal decision-making, thereby weakening incentives for risk-taking, innovation, and enterprise expansion.

iii. Pattern of production:

GST-induced relative price adjustments and input tax credit mechanisms reallocate resources across sectors, enhancing allocative efficiency within formal production networks. However, this structural shift simultaneously disrupts traditional rural value chains and informal production systems, leading to transitional dislocation effects, input substitution, and reconfiguration of production linkages across rural economies.

7. Tax revenue and capital expenditure: A policy gap

One major worry remains the mismatch between revenue raising and development expenditure.

7.1 Present Allocation Trends

Government spending has increasingly reflected futuristic policy orientation with greater allocation, as a result, towards sectors with high growth, such as digital infrastructure, technology, and urban development.

7.2 Neglected Areas

1. Rural Infrastructure (Roads, Storage, Connectivity)

2. Agriculture and Irrigation
3. Generation of employment in rural areas

7.3 Economic Concern

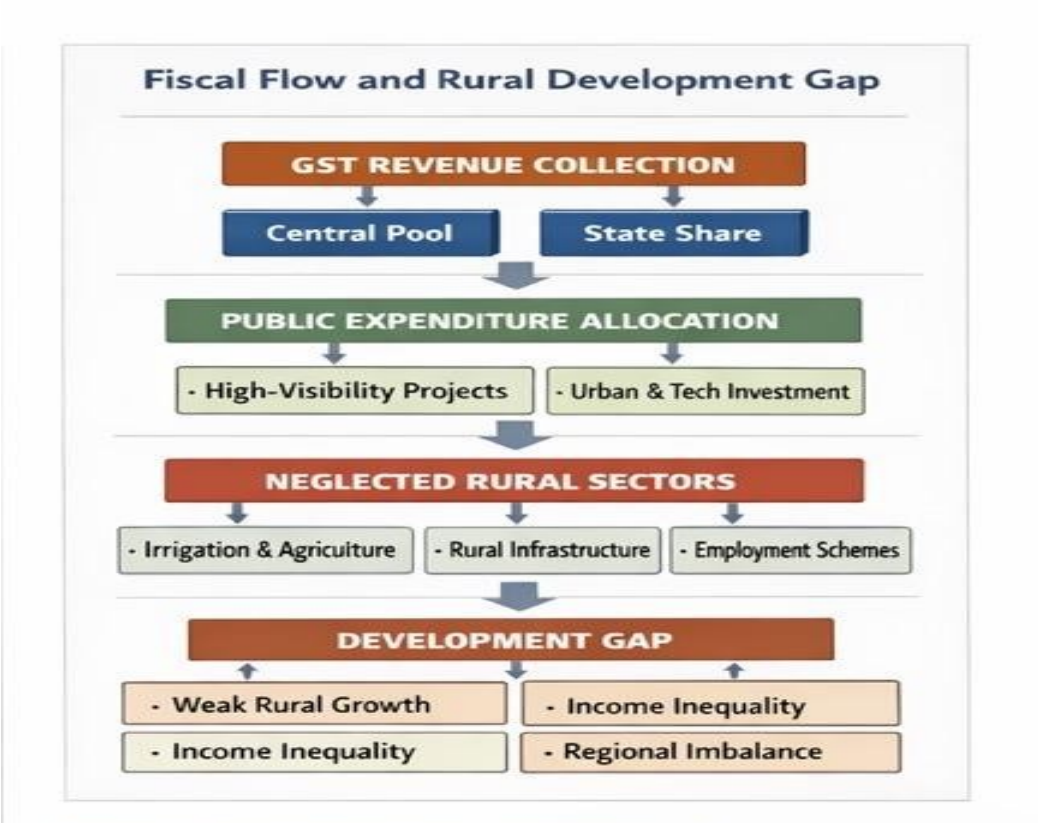
These challenges are pushing the envelopes of both certainty and equity in **intergovernmental fiscal distribution (IGFR).** States with higher rural populations face constraints in financing development expenditure.

Impact

- Slowdown in rural growth
- Few jobs available
- Increasing regional disparity in income

The rural equity in tax for the GST era means that tax revenue for rural people should translate into meaningful rural developmental outcomes.

Figure 3: Fiscal Flow and Rural Development Gap



Source: *Author's conceptual framework.*

8. Centre-State Relations Under GST

GST has increasingly distorted India's fiscal federalism.

8.1 Changing Fiscal Federal Structure

- States have relinquished significant taxation powers (such as VAT)
- A common taxation system has multiplied the levels of interdependence
- The GST compensation had become essential for state revenues.

8.2 Key Issues

- Compensation delay: Deterioration of state finances and welfare spending.
- Diminished fiscal independence: Unable to change tax rates as desired.
- Revenue uncertainty: A 'post-compensation' phase will become volatile.

Theoretical Concern

These challenges are pushing the envelopes of both certainty and equity on iscr fiscal distribution. States populated more by rural citizens face limitations in funding development expenditure.

9. Case Study: Polavaram Project and Fiscal Delays

9.1 Importance of the Project

In this context, large-scale national infrastructure projects assume added significance. The Polavaram Project, constructed on the Godavari River an inter-state river has been accorded the status of a National Project due to its strategic and economic importance. Following the Andhra Pradesh Reorganisation Act, 2014, the Central Government assumed responsibility for its execution and funding.

In this regard, efficient utilization of public revenues, including those mobilized under GST, becomes crucial.

If the Central Government ensures timely allocation of funds and accelerates the completion of the project, it can significantly enhance irrigation capacity, boost agricultural productivity, and promote sustainable regional development in Andhra Pradesh.

9.2 Key Issue

These challenges are both conceptual and practical, they effect implementation, and they effect results possibly in materials some the best s outcome indicators consider es.The shift in fiscal responsibility and administrative control has led to execution challenges.

9.3 Challenges

- Funding delays and ditches
- Administrative overlaps between Centre and State
- Coordination issues with agencies

9.4 Economic Impact

- Delayed irrigation benefits to farmers
- Loss of employment opportunities
- Escalation in project costs due to time overruns

Theoretical Link

This case reflects violations of:

- Economy: Cost of inefficiency rises
- Convenience: Added complexity and delays in administration

It shows all rural economic outcomes how fiscal and institutional friction are directly affected.

10.Rethinking GST for Rural Inclusion

10.1 A Case for the Taxation Being Context Sensitivity

GST is blind to the fact that the informal and rural economies that are made up of small-scale operators and other marginalised segments have very low margins, generate seasonal income, and maintain dismal records.

10.2 Proposed Reforms

Simplified compliance: Quarterly filing and single-page returns for small taxpayers

- **Reduced burden:** Auto-filled returns, vernacular platforms, simplified procedures
- **Awareness programs:** Use of local institutions for GST education
- **Policy integration:** Linking GST participation with rural development schemes

Goal

To design a tax system that is more inclusive, easier to comply/participate with, and more attuned to the capacity of the taxpayer.

11. Tax Morale and Viksit Bharat 2047

11.1 Beyond Taxation

Tax compliance improves when citizens perceive taxation as part of a fair social contract.

11.2 Key Factors for Compliance

- Transparency in revenue utilization
- Fair and stable tax structure
- Visible development outcomes

11.3 For Viksit Bharat 2047

- Strengthen tax morale through trust and accountability
- Ensure rural inclusion in formal growth processes
- Link taxation outcomes with human development indicators

Conclusion:

A successful tax system must balance theoretical soundness with practical inclusiveness. GST reflects the principles of classical taxation in design, but its effectiveness depends on implementation across diverse economic contexts.

For rural India, challenges related to compliance, digital access, and fiscal allocation remain significant. Addressing these requires reforms that prioritize simplicity,

stability, and inclusiveness. Fiscal federalism must ensure predictable and adequate resources for states, particularly for rural development.

Moreover, the alignment of tax revenue with essential capital expenditure is critical. Without adequate investment in rural infrastructure and livelihoods, the redistributive potential of GST remains limited.GST must evolve from a technically efficient system to a socially responsive one. Only then can it contribute meaningfully to the broader vision of **inclusive and sustainable development under Viksit Bharat 2047**.

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