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THE GRAND FEDERAL BARGAIN FOR GOODS AND SERVICES TAX (GST) IN INDIA

Abstract:

On 1 July 2017, India introduced the GST to reform its indirect tax system. In this paper, we analyse the 'grand bargain' for compensation between the states and the central government to bring states on board for tax reforms, and explore the factors behind inter-state variations in the GST revenue shortfall. The paper argues that instead of an all-state uniform revenue protection for the entire transition period, a glide path of the declining level of revenue protection with state-specific revenue benchmark should be preferred while designing compensation schemes accompanying tax reforms. Further, the revenue-losses of net-producing states under GST are structural and likely to last beyond the transition period. Addressing their concerns, possibly through intergovernmental transfers, would instil fiscal trust among states for future reforms. We also show that, by broadening the subnational tax base to include services, the implementation of the GST may enhance the buoyancy of state tax revenues in the long run.

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