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Index

A Decade of GST: A Theoretical Evaluation of Its Successes and Challenges in Commerce

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Abstract

The Goods and Services Tax (GST) was introduced in India on 1 July 2017, under the 101st Constitutional Amendment Act. After nearly a decade of existence, GST has become one of the most important reforms in the commercial and fiscal history of the country. This paper presents a theoretical and conceptual assessment of the trajectory of GST, placing its performance in the context of the theory of optimal taxation, the design of destination-based consumption taxes and cooperative fiscal federalism. The study synthesizes evidence from secondary literature published after 2017 on GST's contribution to market unification, tax buoyancy, formalisation of enterprise and digital tax administration, while critically examining the continued challenges of compliance burden on micro, small and medium enterprises (MSMEs), input tax credit (ITC) frictions, rate multiplicity, classification litigation and centre-state fiscal tensions over the compensation cess. The paper also considers the 2025 ‘GST 2.0’ rate-rationalisation reform as a structural response to a decade of accumulated design frictions. The analysis concludes that GST has been a qualified success for Indian commerce, furthering the constitutional vision of “one nation, one tax, one market” while revealing the limits of a multi-rate, federally negotiated indirect tax architecture. It discusses implications for tax administration, policy design and future research of India’s indirect tax regime.
Keywords: Goods and Services Tax; GST 2.0; reform in indirect tax; fiscal federalism; MSME Compliance; input tax credit; India

Introduction

Indirect taxes have always played a central role in the fiscal architecture of developing economies. They are the largest source of government revenue and a key instrument for market regulation (Andreoni, Erard, & Feinstein, as cited in Garg, Mittal, & Garg, 2025). Prior to July 2017, the indirect tax regime in India was fragmented across a multiplicity of central and state levies—excise duty, service tax, value added tax, octroi, entry tax and a host of cesses—that resulted in a cascading tax-on-tax structure, inter-state trade barriers, and considerable compliance heterogeneity across states (Rao & Mukherjee, 2019). The Goods and Services Tax introduced by the 101st Constitutional Amendment Act and operationalised from 1 July 2017, was conceptualised as a single destination-based value added tax to subsume this fragmented structure into a unified national market (Rao & Mukherjee, 2019). Goods and Services Tax (GST)--implemented in India with the intention of improving revenue efficiency and simplifying tax administration--represented a substantial change in the indirect tax system. (*Cost-Benefit Impact of GST Implementation in India: A Data-Driven Analysis. | EBSCOhost*, n.d.)

Almost a decade later, GST provides a rich empirical and theoretical case to test whether a large, federally negotiated indirect tax reform can provide revenue buoyancy, ease of doing business and equitable centre-state fiscal relations. The reform's own evolution, in the form of the September 2025 'Next-Generation GST' or 'GST 2.0' rate rationalisation that collapsed the four-tier rate structure into a simplified framework (Government of India, Press Information Bureau [PIB], 2025), indicates that GST has continued to be a live policy project rather than a settled institutional arrangement. The paper provides a theoretical assessment of the first decade of GST, positioning the discussion within the most commonly reported successes and challenges in post-2017 scholarship, and frames GST 2.0 as a structural response to accumulated design tensions.

Objectives of the Study

The objectives of the study are as follows:

(i) To investigate the theoretical principles that underpin the design of GST in India;

(ii) To critically assess the claimed successes of GST in terms of commerce, revenue mobilisation and market integration;

(iii) To identify and analyse the persistent structural and administrative challenges in GST implementation; and

(iv) To assess the significance of the 2025 GST 2.0 reform as a corrective response in the decade-long trajectory of the tax.

Research Methodology

The present paper follows a qualitative, doctrinal and conceptual research design. Instead of a primary empirical study, we undertake a theoretical assessment based on a structured review and synthesis of secondary literature – peer-reviewed journal articles, working papers and official government documentation – published since 2017, the period after the implementation of GST. The sources were intentionally chosen to represent a variety of methodological traditions in the GST scholarship including, for instance, econometric assessments of the revenue and growth effects, survey-based studies of MSME compliance behaviour and doctrinal analyses of fiscal federalism. The synthesis is structured thematically based on the four objectives of the study, rather than chronologically, which facilitates an assessment of success and challenges relative to the theoretical frameworks discussed in Section 4.

Theoretical Framework

Optimal Taxation and the Value-Added Tax Model

GST is theoretically based on the value added tax (VAT) model where tax is levied at each stage of the production-distribution chain but is creditable against tax paid on inputs so that the final incidence is only on value addition at point of final consumption. The design objective is to remove the cascading "tax-on-tax" effect of the pre-2017 regime in India and incorporate the principle of destination-based consumption tax in the international context (Rao & Mukherjee, 2019). The theoretical case for a single VAT-type levy is made on three grounds: neutrality with respect to production choices, transparency of the incidence of the tax and administrative simplicity, the results of which can be compared with the empirical record of the past decade.

Fiscal Federalism and the GST Council

Fiscal federalism essentially acts as the circulatory system of a federation, directing the mobilisation, allocation, and expenditure of financial resources and thus determining the actual distribution of power below constitutional formalities.(Jagtiani, 2026).

GST's institutional design also invokes the theory of cooperative fiscal federalism, under which sub-national and national governments pool taxing authority in exchange for coordinated decision-making. The GST Council, comprising the Union Finance Minister and state finance ministers, was created as the constitutional mechanism through which rate-setting and administrative decisions are jointly made (Yadav, 2025). This arrangement required states to surrender significant independent tax-setting authority in return for a five-year revenue-guarantee mechanism funded through a compensation cess (Garg, Priyanka, Narwal, & Kumar, 2023). The tension between centralisation of fiscal authority and the promise of cooperative governance forms a recurring theoretical lens for evaluating GST's federal dimension.

Compliance Cost and Tax Buoyancy Theory

A third theoretical strand concerns the relationship between compliance cost and tax buoyancy — the responsiveness of tax revenue growth to growth in the underlying tax base or GDP. A digitally administered, self-reporting tax such as GST is theorised to widen the formal tax base and improve buoyancy over time, but only if compliance costs do not disproportionately burden smaller economic units, which risk being pushed toward informality rather than formalisation (Mehta & Joshi, 2022). This trade-off between formalisation gains and compliance costs, particularly for MSMEs, underlies much of the empirical literature reviewed in Section 6.

A Decade in Overview: The Trajectory of GST

GST was introduced on 1 July 2017 with a four-tier rate structure of 5, 12, 18, and 28 per cent, with a compensation cess on demerit and luxury goods to ensure states 14 per cent annual revenue growth for five years (Garg et al., 2023). The first few years were marked by a disruptive transition with short-term confusion about compliance and concerns about inflationary pass-through, although later empirical work shows that any price-level effects were transitory rather than structural (Garg, Mittal, & Garg, 2025). The COVID-19 pandemic (2020–2022) exerted intense stress on the compensation mechanism resulting in a long-standing centre-state dispute over the payment of the promised revenue guarantee (Comptroller and Auditor General of India [CAG], 2020). GST entered its second phase of stabilisation with focus on digital enforcement (e-invoicing, e-way bills and Invoice Management System) and revenue consolidation after the compensation guarantee expired in mid-2022. The decade ended with the "GST 2.0" reform in September 2025, which revised rates and compliance mechanisms in what the government described as the most significant overhaul of the indirect tax system since 2017 (PIB, 2025).

Successes of GST for Indian Commerce

Market Unification and Removal of Cascading Taxation

GST's perhaps most obvious theoretical success is the significant reduction in inter-state trade barriers and the cascading of tax. GST has taken forward the constitutional goal of a unified national market by subsuming a haphazard set of central and state levies into a single tax with seamless input tax credit, which enables free movement of goods across state borders and reduces the effective tax burden built into earlier multi-point taxation (Rao & Mukherjee, 2019).

Revenue Buoyancy and Economic Growth

A few econometric studies, published after 2017, have found a statistically significant positive relation between GST revenue growth and GDP growth in India. A study employing ordinary least squares regression for the period 2017-2021 found that a 1 percentage point increase in GST revenue growth was associated with a 0.56 percentage point rise in economic growth (Gokhale Institute research). The complementary work using auto-regressive distributed lag (ARDL) modelling also documents a positive long-run relationship between GST revenue and Indian economic growth (Singhal, Goyal, Sharma, Kumar, & Nagar, 2022). Furthermore, state-level panel based analyses suggest that, over time, GST adoption has been linked to enhanced revenue productivity for a number of sub-national governments over time, despite the short-term volatility created by the compensation transition (Garg, Narwal & Kumar, 2023).

Price Stability Rather than Structural Inflation

When the GST was introduced there was a public concern that the new tax would lead to persistent inflation. Garg, Mittal and Garg (2025) applied Box–Tiao intervention modelling to

Consumer Price Index data and found that any increase in the general price level around the time GST was introduced was temporary and did not create a sustained inflationary shock. Instead, GST is claimed to have helped to promote price stability across several commodity baskets in the medium run by removing embedded cascading taxes.

Digitalisation and Formalisation of Enterprise

The GST architecture, with the GST Network (GSTN), mandatory e-invoicing and algorithmic invoice matching at its core, has successfully brought a large part of the erstwhile informal or semi-formal trade under the digitally traceable tax net. Such a digital-first design has been credited with improving transparency in tax filing and reducing avenues for evasion associated with paper-based, multi-authority tax administration (Government of India, Ministry of MSME, 2023). GST has also been found to formalise input-sourcing relationships and improve access to trade credit as input tax credit claims require verifiable upstream compliance by suppliers (Garg et al., 2023) for businesses able to absorb the initial adjustment cost.

Challenges and Structural Frictions

Compliance Burden on MSMEs

The most commonly reported challenge in the post-2017 literature has been the disproportionate compliance burden GST has imposed on micro, small and medium enterprises. Empirical estimates show that GST-related compliance costs for manufacturing MSMEs can go over four per cent of turnover – well above the one-to-two per cent benchmark globally considered optimal for a well-designed tax system (cited in recent MSME compliance research, 2026). A survey-based research conducted in Karnataka revealed that a majority of MSMEs did not have the internal digital capability to manage the GST portal filing independently and had to depend on external compliance intermediaries, increasing their effective operating costs (Nair, Krishnaswamy, & Reddy, 2021). Frequent changes in filing formats and rate schedules have added to this burden. Mehta and Joshi (2022) found that regulatory uncertainty under GST led to a significant increase in filing errors and a decrease in voluntary compliance consistency among smaller taxpayers, particularly where enforcement pressure was the main driver of compliance rather than internalised trust in the system.

Input Tax Credit and Working-Capital Stress

The integrity of the VAT-type credit chain is dependent on the timely flow of input tax credit (ITC) to downstream businesses. Delays or denials in ITC, whether due to non-compliance by suppliers, mismatch in invoice-matching systems, or procedural changes such as the move to manual invoice acceptance under the Invoice Management System introduced with GST 2.0, have been identified as a key source of liquidity and working-capital stress for smaller enterprises as blocked credit effectively turns a creditable tax into a cascading cost (Government of India, Ministry of MSME, 2023). This friction is in direct tension with the theoretical promise of a neutral, cascading-free VAT structure discussed in section 4.1.

Rate Multiplicity and Classification Disputes

Through much of the decade GST operated with a four-tier rate structure (5, 12, 18 and 28 per cent) and a separate compensation cess, leading to widespread disputes over classification of goods and services under the various rates. This multiplicity vitiated the theoretical simplicity of a single-rate/narrow-band VAT and became a perennial source of litigation and administrative discretion . This was a problem that the 2025 GST 2.0 reform explicitly sought to address by collapsing the 12 and 28 per cent slabs into a simplified structure (PIB, 2025).

Centre-State Fiscal Federal Tensions

GST required states to relinquish significant independent tax-setting powers to the jointly run GST Council, in exchange for a constitutionally protected five-year compensation mechanism (Yadav, 2025). The fragility of this arrangement became apparent with the revenue loss due to COVID-19. A prolonged dispute over payment of compensation erupted when the Centre’s contested argument that a major portion of the revenue loss was due to the pandemic and not due to the GST implementation itself was raised. Several states termed the delay a violation of the cooperative federal bargain that underpinned the adoption of GST (CAG, 2020). The eventual expiry of the compensation guarantee in 2022 has rendered several states more reliant on discretionary central transfers. Some scholars argue that this has shifted India's GST-era federalism towards more centralisation than originally envisioned (Yadav, 2025).

Sectoral and Regional Unevenness

The transition to GST was not uniform across all sectors and regions. Sector-wise studies find that compliance costs were relatively higher for MSMEs in manufacturing than MSMEs in trading or services (Nair et al., 2021). Firms located in states or districts with weak digital infrastructure faced more difficulty in meeting GSTN filing requirements. This variation raises theoretical questions as to whether a uniform national compliance architecture sufficiently accounts for the heterogeneous administrative capacity of India's commercial base.

GST 2.0 (2025): A Structural Response

The comprehensive package of rate rationalisation, popularly called "GST 2.0" or "Next-Generation GST" was approved in the 56th meeting of the GST Council on 3 September 2025 and came into force on 22 September 2025 (PIB, 2025). The earlier four-tier structure was replaced by a simplified regime based on a 5 per cent merit rate and an 18 per cent standard rate, with 40 per cent rate restricted to luxury and "sin" goods such as tobacco, pan masala and aerated beverages. Essential items such as several food items and health and life insurance premia were shifted to nil or lower rates (PIB, 2025). GST 2.0 has introduced procedural reforms along with rationalization of rates to ease the compliance burden of smaller taxpayers. The reforms include pre-filled returns, faster processing of refunds, and ease of MSME registration (PIB, 2025).

Against the challenges set out in Section 7, GST 2.0 can be viewed as a direct corrective, at least theoretically, to the rate multiplicity and classification dispute issues that had built up over the previous eight years, and a partial concession to the compliance cost concerns repeatedly documented in MSME-focused research. At the same time, the reform creates new adjustment frictions, the most salient of which is the shifting of ITC verification onto taxpayers through mandatory invoice acceptance. These frictions echo the working-capital concerns discussed in Section 7.2 and suggest that the structural trade-off between administrative control and ease of compliance remains unresolved rather than eliminated.

Discussion: Weighing a Decade of Reform

From the theoretical perspective of Section 4, the first ten years of GST represent a mixed, but on the whole positive, record. The destination-based, credit-chain model envisioned at its inception has been taken much further by GST, in terms of the dimension of optimal taxation and market neutrality, as evidenced by documented gains on market integration and revenue buoyancy (Rao & Mukherjee, 2019; Singhal et al., 2022). But on the compliance cost theory dimension, the evidence is more cautionary: the persistent gap between GST's design intention and its lived administrative burden – especially for MSMEs – shows that formalisation gains have come with a real and unevenly distributed cost (Mehta & Joshi, 2022; Nair et al., 2021). The compensation cess controversy exposed a structural fragility of a reform premised on the voluntary surrender of fiscal autonomy by the state for a time-bound guarantee in the dimension of cooperative fiscal federalism, and the post-2022 scenario points to the need to renegotiate rather than assume permanence of this bargain (Yadav, 2025). GST 2.0 attempts to resolve the first two tensions through simplification, but the long-term success of the reform will depend on whether procedural changes like manual ITC verification bring back the compliance costs the reform was meant to eliminate.

Conclusion and Policy Implications

This paper provides a theoretical evaluation of India's Goods and Services Tax (GST) in its first decade of operation, situating its performance in the context of optimal taxation, cooperative fiscal federalism, and compliance cost theory. The evidence reviewed suggests that GST has been a qualified success for Indian commerce. It has made a meaningful contribution to market unification and revenue buoyancy, while revealing structural weaknesses in compliance design, input tax credit administration and centre-state fiscal relations. The policy implications are three-fold. Firstly, the differential impact of future rate and procedural reforms on MSMEs should be explicitly assessed, considering the disproportionate compliance burden borne by this segment so far. Second, the institutional design of centre-state revenue sharing under GST would benefit from a more durable rules-based mechanism to deal with asymmetric revenue shocks, rather than relying on time bound guarantees that are renegotiated. Third, the procedural changes introduced by GST 2.0, particularly the move to taxpayer-verified invoice matching, need to be monitored on an ongoing basis to ensure that simplification at the rate level is not offset by new compliance frictions at the administrative level. The conclusions of this paper are necessarily limited by the secondary literature reviewed as this is a conceptual and doctrinal study. Future empirical research using data post-2025 will need to assess the realized effects of GST 2.0 on compliance cost, revenue buoyancy and MSME formalisation.

Limitations of the Study

This study is conceptual and theoretical in nature, drawing exclusively on secondary sources published after 2017; it does not generate primary survey or transaction-level data. Given the recency of the GST 2.0 reform (effective September 2025), the empirical literature evaluating its effects remains limited at the time of writing, and conclusions regarding its impact are necessarily provisional.

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