

Fiscal Federalism and the Evolving Centre-State Dynamics: A Comparative Evaluation of India's GST Framework Against Global Best Practices

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ABSTRACT: *This study presents a comparative analysis of India's goods and services tax (GST) framework with fiscal federalism models in Canada, Australia, Brazil, and Germany. It examines the foundations of fiscal federalism and provides cross-country comparisons across six indicators. It also evaluates India's GST design using international best practices. The analysis shows that India's GST represents significant centralization of indirect tax powers, constraining state autonomy more than comparable federal systems. While the dual GST achieved market unification and compliance simplification, it also introduced dependencies through temporary compensation mechanisms and asymmetric institutions. Canada's provincial flexibility, Australia's transparent equalization, and Germany's constitutional revenue-sharing offer contrasts that highlight reform opportunities in India. The findings indicate that fiscal uncertainty, limited state autonomy, and the GST Council's Center-dominant dynamics challenge the federal balance. This study concludes with policy recommendations addressing institutional reform, revenue-sharing, dispute resolution, and MSME-focused improvements to strengthen fiscal federalism while preserving the benefits of the GST.*

KEY WORD: *Fiscal Federalism, GST, Revenue Sharing, Tax Autonomy, Equalization Mechanisms*

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I. INTRODUCTION

Fiscal federalism, the allocation of taxing powers, expenditure responsibilities, and transfers across government levels, remains central in multi-tiered governance systems. The design of federal fiscal reforms that shapes economic efficiency, regional equity, macroeconomic stability, and subnational autonomy. The implementation of the Goods and Services Tax (GST) in India signifies a crucial transformation in the nation's fiscal federal structure, transitioning towards a destination-based consumption tax system (Ananda, 2024; Tremblay, 2023). Enacted on July 1, 2017, this reform amalgamated various indirect taxes at both the central and state levels, with the objective of streamlining the tax framework and enhancing economic efficiency (Shome, 2021). This substantial modification in the fiscal landscape necessitated a reassessment of the financial relationships between the Union and the States, particularly in terms of revenue assignments and expenditure responsibilities (Vithal & Sastry, 2001). However, this transition has introduced complexities, notably concerning the reduced fiscal autonomy of states due to the subsumption of buoyant revenue sources such as sales tax/value added tax (VAT) and restrictions on independent surcharges (Ananda, 2024; Tremblay, 2023). Consequently, the shift has intensified debates regarding the appropriate mechanisms for intergovernmental fiscal transfers, particularly the role of grants for equalization versus traditional tax-sharing models, to ensure that states can effectively meet their expenditure mandates (Chakraborty, 2019). This issue is particularly critical given the pre-existing condition in which revenue-generating powers were predominantly vested with the Union, while states bore a larger share of expenditure responsibilities (Dwivedi & Gurpur, 2023). The constitutional framework governing fiscal federalism in India, including the roles of the State and Central Finance Commissions, has historically provided mechanisms for these intergovernmental transfers, however, the GST regime has necessitated a reevaluation of these frameworks (Mishra et al., 2021). While the GST aimed to foster cooperative federalism by creating a unified market and mitigating the cascading effect of taxes, its actual implementation has presented challenges related to declining revenue buoyancy for states and administrative

hurdles (Dwivedi, 2024; Isaac, 2024). For instance, the significant growth in total GST revenue from 5,39,601 crore rupees in 2017-18 to 15,18,127 crore rupees in 2023-24, while indicative of overall economic expansion, does not uniformly translate into enhanced fiscal capacity for all states, with some high-contributing states strengthening their positions while others face persistent challenges (N & Indumati, 2024).

India's implementation of the Goods and Services Tax (GST) in 2017 constitutes a major fiscal reform, delineating indirect tax authority between the central government and the states. This study examines India's GST framework in comparison with fiscal federalism models in Canada, Australia, Brazil, and Germany. These countries present varied approaches to managing national market integration and subnational fiscal autonomy, offering benchmarks for assessing India's strategy.

Objectives of the Study

1. To establish the theoretical foundations of fiscal federalism through the application of established frameworks
2. To compare legislative tax powers, rate-setting autonomy, revenue-sharing formulas, equalization mechanisms, and dispute resolution frameworks across five countries.
3. To evaluate the centralization, autonomy constraints, and structural characteristics of India's GST system.
4. To offer policy recommendations aimed at strengthening the federal balance and enhancing outcomes for micro small and medium enterprises (MSMEs) within India's GST regime.

II. LITERATURE REVIEW

Fiscal federalism has been central to academic and policy research over the past decade. The focus has been particularly on the balance between centralization and subnational autonomy in indirect tax reforms such as the goods and services tax. Foundational frameworks such as Musgrave's three-function model and Oates' decentralization theorem have given an understanding of the fiscal arrangements. These models stress the importance of aligning taxing powers with expenditure responsibilities to improve welfare and efficiency (Boadway & Shah, 2009; Oates, 1972). A key emphasis lies on eliminating vertical and horizontal fiscal imbalances through mechanisms such as equalization transfers and revenue-sharing formulas. Empirical studies have examined GST implementations within federal systems. India's 2017 dual GST structure is a frequent subject, noted for its centralization of indirect tax powers combined with state participation via the GST Council (Rao & Vaillancourt, 2020). Although India's GST has facilitated market integration and simplified compliance, challenges are still present in centralization and limited state autonomy in setting tax rates (Ministry of Finance, Government of India, 2023; Press Information Bureau, 2025). This contrasts with countries like Australia and Canada, where permanent, formula-driven equalization and greater subnational tax flexibility promote fiscal autonomy and predictability (Commonwealth Grants Commission, 2023; Department of Finance Canada, 2024). Germany's constitutionally mandated VAT revenue-sharing and horizontal equalization mechanisms contribute to fiscal stability and reduce renegotiation risks (Basic Law for the Federal Republic of Germany, n.d.; European Commission, 2024). Brazil's decentralized ICMS system adapts strong subnational autonomy but faces coordination and compliance challenges (Tesouro Nacional, 2023). Recent analyses have also focused on the impact of GST reforms on MSMEs. These studies highlight compliance burdens and liquidity constraints faced by MSMEs, emphasizing the need for efficient refund processes to support their growth (Ministry of Finance, Government of India, 2023). The literature recommends institutional reforms in India's GST framework. Recommendations include establishing permanent equalization mechanisms, enhancing dispute resolution, and rebalancing Center-State dynamics to sustain the benefits of fiscal federalism (Rao & Vaillancourt, 2020; Press Information Bureau, 2025).

2.1 Musgrave's Three-Function Framework

The foundation for assigning fiscal responsibilities across government levels rests on Musgrave's classification of public sector functions: allocation, distribution, and stabilization. This framework guides the determination of the level at which particular fiscal instruments should be exercised. The allocation function addresses public goods provision and market failures. Subnational governments should provide public goods with local benefits, whereas those with national spillovers warrant central provision. The distribution function concerns income redistribution and equity. Given factor mobility, redistribution is typically centralized to prevent "race to the bottom" dynamics. The stabilization function involves macroeconomic management through fiscal and monetary policies. Stabilization tools are generally unified as subnational governments face borrowing constraints and cannot effectively manage aggregate demand. These functions frame the assignment of expenditure responsibilities and revenue instruments. (Musgrave, 1959).

2.2 Oates’ Decentralization Theorem and Revenue Assignment

Wallace Oates’ decentralization theorem provides a microeconomic basis for subsidiarity in fiscal federalism. The theorem states that the decentralized provision of public goods maximizes welfare when there are no centralization efficiencies or interjurisdictional externalities, as it allows local preference customization. Taxes should be assigned to government levels that best internalize benefits and costs while minimizing spillovers. Mobile tax bases such as capital are allocated to central governments, whereas, immobile bases such as land suit decentralization. Benefit taxes should match the service-providing level. The theorem emphasizes the alignment of revenue capacity with expenditure needs. When subnational governments lack sufficient revenues for their responsibilities, intergovernmental transfers become necessary, and their design affects fiscal autonomy (Oates, 1972).

2.3 Vertical and Horizontal Fiscal Imbalance

According to the fiscal federalism theory, there are two types of fiscal imbalance. Vertical fiscal imbalance (VFI) occurs when revenue-raising capacity mismatches expenditure responsibilities across government levels. VFI is common when central governments control major tax bases while subnational governments handle significant expenditures. This necessitates intergovernmental transfers, although excessive VFI can reduce subnational accountability. Horizontal fiscal imbalance (HFI) refers to differences in fiscal capacity across subnational jurisdictions due to uneven economic activity or demographic changes. Without correction, the HFI leads to inequitable service provision. Equalization transfers from stronger to weaker jurisdictions enable comparable public services across the regions.

2.4 Tax Autonomy versus Harmonization Trade-off

Fiscal federalism faces a trade-off between subnational tax autonomy and harmonization. Tax autonomy strengthens accountability and local preference matching but can break markets and create compliance expenses. Tax harmonization addresses these inefficiencies by coordinating tax systems across jurisdictions, which is valuable for consumption taxes. The harmonization-autonomy trade-off involves institutional design choices. Countries can harmonize bases while allowing rate flexibility or centralize collection while sharing revenues. Where deep harmonization occurs, governments generally compensate subnational units through revenue-sharing or institutional mechanisms that preserve political participation. These frameworks provide a foundation for evaluating India’s GST and comparing it with global fiscal federalism models.

III. Global Indicator Comparison

The following table summarizes the legislative division of tax powers, rate-setting autonomy, revenue-sharing formulas, equalization mechanisms, intergovernmental institutions, and dispute resolution frameworks across India, Canada, Australia, Germany, and Brazil.

Table 1: Comparative Fiscal Federal Indicators Across Selected Federations

Indicator	India	Canada	Australia	Brazil	Germany
Legislative division of tax powers	Center–state assignment reconfigured by GST; many indirect taxes moved to dual GST with Center and States sharing the base; Finance Commission handles other fiscal transfers	Provincial constitutional authority over many direct taxes; federal government controls and transfers; provincial VAT/consumption taxes vary by province	Constitution gives Commonwealth major taxation powers; states have limited tax bases (land, payroll, stamp duties); horizontal redistribution mainly via Commonwealth grants	Federal constitution assigns many taxes across levels; municipalities, states, and federation have overlapping bases; intergovernmental transfers are significant	Tax powers shared; significant revenue-sharing arrangements between Bund and Lander with constitutional and statutory rules governing assignment
Rate setting autonomy	Limited for indirect taxes under GST slabs negotiated jointly via GST Council; states retain some component but upon agreed design	Provinces have strong autonomy on many tax rates and bases	States have constrained rate-setting on major bases; Commonwealth dominates income taxation	Subnational rate autonomy exists but is constrained by constitutional assignments and intergovernmental sharing rules	Lander have limited autonomy on some taxes but receive shares from shared taxes (e.g., VAT) with rules designed to preserve uniformity

Indicator	India	Canada	Australia	Brazil	Germany
Revenue sharing formula	Shared GST pool for IGST/CGST/SGST with predefined apportionment rules and special grants/compensation during transition	Federal transfers include equalization and conditional transfers; sharing varies by program and negotiation	Commonwealth collects large share of national revenue and redistributes through general and specific purpose payments using formulas and negotiations	Transfers include constitutional revenue-sharing, conditional funds, and redistributive transfers based on formulas and legal mandates	Complex revenue-sharing statutes apportion major taxes and provide payments between levels based on formulas
Equalization mechanism	Temporary GST compensation to states plus Finance Commission grants and specific purpose grants to address HFI and VFI	Formal equalization program redistributes federal revenue to ensure comparable services across provinces	Commonwealth Grants Commission recommends vertical and horizontal distribution to states to equalize fiscal capacity	Constitutional mechanisms (e.g., Fundo de Participação) aim to equalize among states and municipalities	National equalization (Länderfinanzausgleich) redistributes among Länder to reduce fiscal disparities
Inter governmental institutional mechanism	GST Council (Center + states) plus periodic Finance Commission set transfer principles and formulas	Federal–provincial councils and intergovernmental negotiation mechanisms are routine in fiscal practice	Formal bodies (e.g., COAG historically) and commission processes mediate fiscal relations	Multiple intergovernmental councils and fiscal rules coordinate transfers and responsibilities	Structured federal institutions and statutory mechanisms manage fiscal transfers and coordination
Dispute resolution framework	GST Council as policy making forum; specifics of judicial/appellate dispute mechanisms	Country-level intergovernmental dispute mechanisms combine political negotiation and courts as arbitration/backstop	Dispute resolution relies on institutional negotiation and legal avenues with commissions advising on fiscal shares	Institutionalized councils and constitutional/legal remedies structure dispute resolution, though details vary by case	Disputes can be adjudicated via constitutional courts and resolved through statutory procedures; institutionalized sharing reduces recurring conflicts

IV. Conceptual Framework

The analysis is based on Musgrave’s functional assignment framework, which encompasses allocation, distribution, and stabilization, as well as Oates’ decentralization theorem and the concepts of vertical and horizontal fiscal imbalance. These theoretical foundations establish standard criteria for evaluating the structuring of taxing authority, expenditure responsibility, and intergovernmental transfers within the federal systems. Building on these principles, the framework operationalizes fiscal federal design through measurable institutional indicators, such as legislative tax powers, rate-setting autonomy, revenue-sharing arrangements, equalization mechanisms, intergovernmental coordination structures, and dispute-resolution mechanisms. These indicators help in structured comparisons across federal GST/VAT systems and assist in estimating institutional balance. The institutional features influencing outcomes, such as the degree of fiscal centralization, constraints on state autonomy, and regulatory implications for MSMEs are evaluated. Finally, the policy directions focused on institutional reform, revenue-sharing stability, dispute resolution are informed. It provides an integrated structure for assessing the evolving Center–State fiscal dynamic under India’s GST from a comparative perspective, as shown in Figure 1 below.

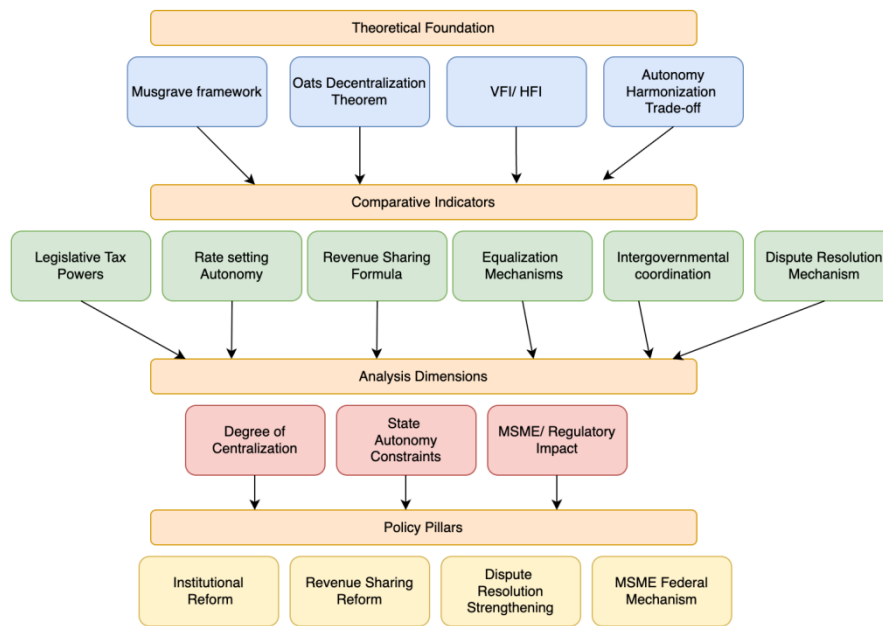


Figure 1: Conceptual Framework of the study.

Source: Author generated

V. Methods

This study employs a comparative institutional design, supported by secondary fiscal data analysis, to evaluate India’s GST architecture from the perspective of fiscal federalism. It conducts a comparative analysis of selected federal systems using clearly defined institutional indicators. The research design was explanatory in nature. This study assesses whether India’s GST framework represents a sustainable equilibrium between harmonization and federal stability.

5.1 Country selection rationale for comparison

In the process of selecting countries for comparative analysis, several aspects of fiscal federal design pertinent to India’s GST system were taken into account. Table 2 shows that Australia employs a centralized GST system characterized by permanent rules for equitable distribution. In contrast, Canada allows regions to set their own tax rates while conforming to the national equalization framework. Germany allocates revenue based on constitutional provisions, permitting limited modifications to tax rates. Brazil, on the other hand, grants regions substantial control over indirect taxes and enforces rules for fund redistribution.

Country	Federal Structure Type	Relevance to India’s GST Analysis
India	Dual GST with shared base	Harmonized but centralized GST structure
Australia	Centralized GST with redistribution	Benchmark for rule-based capacity equalization
Canada	Decentralized federal tax model	Benchmark for subnational tax flexibility
Germany	Constitutionally shared tax system	Benchmark for institutional entrenchment and stability
Brazil	Highly decentralized indirect taxation	Example of autonomy with coordination complexity

Table 2: Rationale for Comparative Country Selection

Source: Author generated

VI. Comparative Tables

The following tables summarize the important institutional and fiscal differences among the five federations. Table 3 shows that India’s GST compensation is time-bound and growth-based, unlike Australia, Canada, Germany, and Brazil, which have permanent equalization backed by statutory or constitutional

provisions. Capacity-based fiscal equalization is explicit in Australia, Canada, and Germany, while Brazil relies on constitutionally fixed redistributive funds; India lacks a permanent GST-specific capacity equalization mechanism. Table 4 highlights the variation in subnational tax rate authorities. Canada and Brazil allow greater provincial/state discretion, India and Australia have limited subnational autonomy in indirect taxes, and Germany enforces uniform VAT rates with revenue-sharing protections instead of rate discretion. Table 5 outlines the differences in aggregate VAT/GST revenue size and redistribution structures, reflecting variations in fiscal capacity, revenue scale, and constitutional entrenchment.

Table 3: Fiscal Equalization Mechanisms (Cross-Country)

Country	Permanent Equalization (Y/N)	Capacity-Based Formula	Independent Technical Body	Constitutional Entrenchment	Funding Source
India	No (GST-specific)	No(Growth based guarantee)	No	No (Compensation temporary)	Compensation Cess
Australia	Yes	Yes	Yes (Commonwealth Grants Comission)	Indirect (Intergovernmental Agreement)	100% GST Pool
Canada	Yes	Yes	No independent commission; formula legislated	Yes (Constitution Act, 1982 reference)	Federal Revenues
Germany	Yes	Yes	No separate body; formula constitutionally embedded	Yes (Basic Law Arts. 106–107)	Shared VAT & taxes
Brazil	Yes	Partially (redistributive coefficients)	No	Yes (1988 Constitution)	Federal shared taxes

Source: Author’s compilation based on government fiscal reports and official constitutional provisions(see references below)

Table 4: Subnational (state level) Fiscal Autonomy Indicators

Country	Subnational Rate Autonomy	Shared Tax Bases	Ability to Modify Base	Independent VAT/GST Rate Setting	Central Dominance Level
India	Low	Yes	Limited	No GST council controlled	High
Australia	High	Yes	Yes	Yes(PST/HST)	Moderate
Canada	Low	No(Central GST)	No	No	Low
Germany	Low	Yes	Limitd	No	Moderate
Brazil	High	Yes	Yes	Yes	Low-Moderate

Source: Author’s compilation from OECD fiscal decentralization data and official national finance ministry reports.(See references below)

Table 5: Empirical Revenue & Equalization Outcomes

Indicator (2023–24/ 2024–25)	Tax-to-GDP Ratio	Total GST/VAT Revenue	Equalization Permanent	Redistribution Mechanism	Subnational Tax Share (%)
India	~11.7 % in 2024–25*	22.08 lakh crore rupees(2024-25 est.)	No	Compensation expired	~35–40% combined
Australia	(approx. OECD avg ~33–34 %)	~AUD 83B GST pool (2023-24)	Yes	CGC Relativities	~45% incl. GST
Canada	(approx. OECD avg ~33–34 %)	CAD 51–52 billion (approx.) (2023-24)	Yes	Formula-based equalization	~40%

Indicator (2023–24/ 2024–25)	Tax-to-GDP Ratio	Total GST/VAT Revenue	Equalization Permanent	Redistribution Mechanism	Subnational Tax Share (%)
Germany	~38.0 %	289.96 billion euros(2023-24)	Yes	Constitutional VAT sharing	~24–30%
Brazil	ICMS major state tax	BRL 750–800 billion (approx.) (2023-24)	Yes	Constitutional participation funds	High state share

Source: Author’s compilation based on RBI (2024), OECD (2024), European Commission (2024), Commonwealth Grants Commission (2023), Department of Finance Canada (2024), and national treasury reports. (See references below)

VII. Discussion

The comparative evidence presented in Tables 3–5 highlights the distinct structural differences in the design, permanence, and institutional insulation of fiscal equalization and tax autonomy across federations. While India’s GST framework exhibits coordinated revenue-sharing and substantial aggregate collections, it differs from comparator systems because of the absence of a permanent, capacity-based equalization mechanism and the extent of subnational rate discretion. These institutional contrasts prompt significant inquiries regarding the long-term implications of harmonization for fiscal balance, state autonomy, and regulatory predictability. The subsequent discussion interprets these findings through the lens of fiscal federalism theory to evaluate whether India’s GST architecture achieves a sustainable equilibrium between central coordination and the subnational fiscal stability.

7.1 Country-Wise Factual Observations

India’s GST Revenue and Distribution Patterns

In the fiscal year 2024-25, India’s total GST collections reached an unprecedented 22.08 lakh crore rupees, marking an approximate 9.4% increase compared to the previous year. This growth indicates of enhanced formalization and compliance with tax regulations. In May 2024, the monthly gross GST collections amounted to 1.73 lakh crore rupees, reflecting an 11.3% rise from the previous year. Net collections, after refunds, also experienced an increase of approximately 11.6%, demonstrating sustained revenue buoyancy beyond the initial phases. Information from the central intergovernmental settlement reveals an equitable distribution of the Integrated Goods and Services Tax (IGST) between the Central Goods and Services Tax (CGST) and the State Goods and Services Tax (SGST). For instance, in May 2024, CGST was approximately 38,519 crore rupees and SGST around 32,733 crore rupees, illustrating the ongoing application of the destination principle. Recent provisional data on state-wise GST collections reveal varied growth patterns; for example, Delhi experienced an approximate 22% rise in August 2024, whereas some Northeastern states, such as Nagaland, faced declines, emphasizing fiscal disparities at the state level. State-specific data, such as Haryana’s SGST growth over a decade, indicate that sub-regional economic clusters can significantly influence collections, highlighting the diverse revenue capacities of different states. While India’s GST demonstrates robust national revenue growth, the outcomes at the state level are uneven, which is pertinent to fiscal equalization and the maintenance of vertical balance.

Australia’s GST Pool Distribution Under Horizontal Fiscal Equalisation

The 2023 update of GST revenue sharing relativities by the Commonwealth Grants Commission delineates the distribution of GST revenues among states and territories for the fiscal year 2023-24, based on fiscal capacity and service expenditure requirements. This framework ensures that no state is disadvantaged relative to a baseline and incorporates a floor mechanism (e.g., GST relativities guarantee a minimum return), thereby institutionalizing equalization. Recent reports indicate significant redistribution outcomes for 2024 to 2025, with Victoria projected to receive an additional AUD 3.8 billion in GST revenue due to revised relativities, while states such as New South Wales (NSW) and Queensland are expected to experience a reduction in their share due to their stronger revenue-raising capacity. Australia’s formula-based, rule-driven GST equalization mechanism results in predictable state distributions, in contrast to India’s transitional compensation model.

Canada’s GST/HST Structure and Province-Level Variation

The Canadian federal Goods and Services Tax (GST) is established at a rate of 5%. In certain provinces, such as Nova Scotia, Newfoundland, and Prince Edward Island (PEI), this tax is integrated with provincial sales taxes to form a Harmonized Sales Tax (HST) of up to 15%. In provinces that do not implement the HST, the GST is collected at the standard rate of 5%, while provincial retail taxes (PST) are imposed separately. This arrangement illustrates the coexistence of federal and subnational tax systems. Although not directly comparable to GST revenue sharing, Canada’s federal equalization payments are determined by a formula and are designed

to equalize provincial fiscal capacity across various tax bases, including consumption taxes. The Canadian model demonstrates provincial rate flexibility and integrated harmonization variants, in contrast to with India's uniform GST structure.

Germany's VAT Revenue and State Share Dynamics

In 2024, Germany's total tax-to-GDP ratio was 38.0%, surpassing the OECD average of approximately 34.1%, thereby indicating a robust aggregate tax system in which VAT constitutes a major component. According to EU data, Germany collected approximately 289.96 billion euros in VAT in 2023, with an estimated compliance gap of approximately 9.7% of the total tax liability, offering a measure of VAT efficiency. Tax revenue statistics reveal that subnational governments (Länder) account for approximately 24.3% of the total tax revenues in Germany, highlighting significant decentralized fiscal authority. Germany's VAT system is characterized by a high degree of integration with substantial subnational revenue responsibilities and a formalized equalization mechanism, presenting a contrast to India's compensation framework.

Brazil's State VAT (ICMS) Fragmentation

In Brazil, the state-level VAT equivalent, known as ICMS, is managed independently by each state. The standard rates generally range from 17% to 18%, but can locally escalate to approximately 25%. This decentralized approach contrasts with India's Goods and Services Tax (GST), which was designed to address issues such as compliance complexity and inter-state competition that are inherent in Brazil's ICMS system. The diversity in ICMS rates exemplifies a decentralized fiscal model that presents coordination challenges, unlike the more unified structure of India's GST.

India's GST demonstrates strong revenue growth with record collections, however, state-level distribution reveals significant disparities, underscoring the need for enhanced fiscal equalization measures. In contrast, Australia employs a formula-driven equalization mechanism through the Commonwealth Grants Commission, actively redistributing GST revenues based on states' fiscal capacities and expenditure requirements. Canada's GST/HST system varies by province, reflecting different degrees of federal-subnational integration and diverse tax rate structures. Germany's VAT constitutes a major revenue source with substantial subnational shares, supported by formalized federal fiscal balance frameworks. Meanwhile, Brazil's decentralized ICMS system grants states considerable rate-setting autonomy but faces challenges related to compliance and inter-jurisdictional coordination, issues that India's GST aims to address through unified tax administration and reduced fragmentation.

VIII. Comparative Analysis

8.1 Australia's Equalization vs India's Compensation

Australia's horizontal fiscal equalization (HFE) and India's goods and services tax (GST) Compensation Mechanism both aim to address fiscal imbalances, yet they differ in terms of permanence and structural design. In Australia, the entirety of GST revenue, amounting to AUD 83.1 billion in 2023–24, is allocated to states based on annually recalculated relativities determined by the Commonwealth Grants Commission. This allocation is guided by considerations of fiscal capacity and expenditure needs (CGC, 2023-24). The Australian system is characterized by its permanence and formula-driven approach. Conversely, in India, GST collections reached 22.08 lakh crore rupees in the fiscal year 2024–25. However, the compensation mechanism, which assured a 14% annual revenue growth from 2017 to 2022, was transitional. Following 2022, there is no established permanent GST-specific equalization framework, thereby increasing the fiscal vulnerability of states that previously depended on compensation transfers.

Implications for India

Australia's model offers a robust approach to fiscal imbalances through permanent, technical, and independent mechanisms that provide predictability and reduce political conflict. India's temporary compensation system secured state GST buy-in but created fiscal uncertainty. India needs a permanent, independent, and equalization mechanism to achieve fiscal stability.

8.2 Germany's Constitutional Revenue Formula and Stability

Germany embeds revenue sharing constitutionally under Articles 106–107 of the Basic Law (Grundgesetz), which specify how major taxes such as VAT, are distributed between the Federation (Bund) and the Lander. VAT is jointly shared, and the allocation formula incorporates horizontal equalization (Landerfinanzausgleich) to adjust for fiscal capacity differences. In 2023, Germany collected approximately 289.96 billion euros in VAT, with revenue distributed according to constitutionally defined percentages and equalization transfers (European Commission VAT statistics) Because distribution rules are constitutionally entrenched rather than politically renegotiated annually, Germany achieves high fiscal predictability. This

constitutional anchoring limits discretionary bargaining and enhances long-term subnational fiscal planning stability.

Lessons for India

Germany's fiscal federal model offers important lessons for India's GST-based federalism. Germany's constitutional VAT revenue sharing establishes guidelines that reduce renegotiation risks and improve fiscal predictability. Their permanent, capacity-based equalization mechanism redistributes fiscal capacity through formula-driven rules, unlike India's temporary GST compensation. Germany ensures institutional insulation by vesting fiscal disputes in the Constitutional Court (Bundesverfassungsgericht) and maintaining legal revenue sharing formulas. Federal-state coordination occurs through the Bundesrat, whereas, India's GST Council needs clearer rules. Germany's equalization system balances redistribution with fiscal effort, a principle India should adopt in its GST framework.

8.3 Critical Evaluation of India's GST

India's GST has achieved significant milestones, including the simplification of tax compliance, the broadening of the tax base, the enhancement of transparency, and the promotion of a unified national market through the elimination of the cascading effect of taxes. Despite these accomplishments, GST also presents certain weaknesses, such as complexities in filing procedures, frequent changes in tax rates and regulations, and challenges encountered by small and medium sized enterprises in adapting to the new system. These strengths and limitations collectively shape the impact of GST on India's economic framework.

8.3.1 Strengths of Indian GST

India's Goods and Services Tax (GST), established by the Constitution (101st Amendment) Act of , 2016, marks a significant reform in the country's fiscal federal structure. It replaced a fragmented indirect tax system with a destination-based, value-added tax, enhancing market integration by eliminating inter-state check-posts and cascading taxes, thereby improving the supply chain efficiency. The dual constitutional framework grants concurrent legislative authority to both the Union and States, preserving the subnational tax identity. The GST Council institutionalizes cooperative federalism through a weighted voting system that fosters consensus among stakeholders. Additionally, the GST Network (GSTN) provides a centralized digital platform for registration, return filing, and compliance monitoring, thereby increasing administrative efficiency and reducing evasion. The GST (Compensation to States) Act, 2017, ensured 14% annual revenue growth for five years, easing the political acceptance of the reform. These features demonstrate India's efforts to balance efficiency, federalism, and revenue stability in its GST framework.

8.3.2 Structural weaknesses of India's GST

There are several structural deficiencies in India's GST framework, emphasizing the tension between centralized control and subnational fiscal autonomy. The dominance of rate-setting power in the GST Council limits the states' ability to customize tax policies, in contrast with more decentralized models such as Canada. The cessation of the compensation mechanism has increased revenue instability for states, drawing attention to the absence of a permanent equalization system similar to those in Australia and Germany. The multiplicity of tax slabs complicates administration, increasing compliance challenges and dispute potential. Although the IGST settlement process is innovative, its operational complexity generates liquidity and timing issues. Embedding political negotiations within the GST Council introduces risks of policy volatility, lacking the stability afforded by independent fiscal bodies internationally. These stringent compliance demands affect MSMEs, contributing to regulatory uncertainty. All these weaknesses reveal persistent challenges in harmonizing fiscal federalism, administrative efficiency, and political dynamics within India's GST regime.

8.3.3 Policy implications of India's GST for MSMEs

India's GST reform exerts a substantial influence on MSMEs, particularly concerning compliance burdens, liquidity management, market access, and regulatory predictability. Delays in input tax credit refunds and Integrated Goods and Services Tax (IGST) settlements impose significant pressure on MSME cash flows, necessitating prompt refund processing and interest compensation for such delays. Simplifying compliance through expanded composition schemes, unified quarterly filings, and standardized classifications can mitigate costs and promote formalization. To enhance regulatory predictability, it is essential to implement a minimum notice period before rate changes and establish an annual policy roadmap. Digital facilitation centers and subsidized compliance software can address the technical challenges faced by MSMEs, while integrating GST data with credit schemes can improve access to formal credit. Fiscal federal stability is crucial and requires mechanisms such as permanent GST equalization and standardized enforcement to ensure consistent practices. Efficient dispute resolution through fast-track benches and mediation can reduce legal burdens. The policy must

focus on reducing administrative friction, stabilizing liquidity, improving predictability, and linking compliance with credit access to support the growth of MSMEs in India.

IX. Conclusion

India's Goods and Services Tax represents a major change in taxation, simplifying compliance but centralizing fiscal authority and reducing state autonomy. This study compares India's GST with the tax systems in Canada, Australia, Brazil, and Germany, where frameworks balance revenue collection with expenditure needs and local governance. India's GST is more centralized than those of these nations. Canada's provinces can set their own taxes, Australia ensures equal distribution despite central collection, Germany uses stable revenue-sharing, and Brazil maintains local control. India's GST Council holds substantial power, limiting states' fiscal autonomy through provisional payments that increase their dependency on the central government. This centralization creates power imbalances and complicates state fiscal planning. While the GST has improved market incorporation, its excessive unification, payment issues, and inadequate dispute resolution cause challenges to the sustainability of fiscal federalism. Small enterprises benefit from simplified registration but face obstacles from new regulations and delayed refunds. The study recommends reforms to balance the power between the central and state governments through GST Council modifications, equitable revenue sharing, and state rate-setting authority. Better dispute resolution and streamlined regulations can improve predictability. While international countries offer insights, India's unique context requires specific approaches. The success of GST depends on addressing these challenges to sustain benefits and local governance.

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