



Central Government Financing in the Post-GST Era: Trends, Issues, and Challenges

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Abstract:

The introduction of the Goods and Services Tax (GST) in 2017 marked a watershed moment in India's fiscal federalism. While it aimed to simplify the indirect tax structure and enhance revenue efficiency, the post-GST era has ushered in a new set of challenges in central government financing. This research article critically examines the evolving landscape of central government finance in the post-GST regime by analyzing trends in revenue generation, expenditure patterns, compensation mechanisms to states, and the implications for fiscal autonomy. The study also highlights emerging issues and challenges, such as revenue shortfalls, compensation cess uncertainties, and intergovernmental tensions. Through a review of government data, finance commission reports, and scholarly analyses, the article provides a nuanced understanding of India's central financial administration in the wake of GST.

Keywords: Central Govt. Financing, Revenue, GST, Trends, Challenges.

Introduction:

The adoption of the 'Goods and Services Tax (GST)' in India on July 1, 2017, was hailed as a major structural reform that aimed to unify the country's complex indirect tax regime. It subsumed "a multitude of central and state taxes, thereby creating a single national market for goods and services" (Kelkar, 2019). The GST system replaced central excise duty, service tax, and additional customs duties with the Central GST (CGST), Integrated GST (IGST), and compensation cess, significantly transforming the revenue structure of the central government.

"While GST has streamlined tax administration and enhanced transparency, it has also redefined the contours of central government financing. The role of the central government in compensating states for revenue losses and managing fiscal federalism has increased" (Kelkar, 2019). Simultaneously, concerns have grown regarding revenue adequacy, fiscal deficits, and the balance between "central and state fiscal powers" (Rao, 2020). Before "the implementation of GST, the central government derived a significant portion of its tax revenue from indirect taxes such as central excise duty, service tax, and customs duties" (K.J. Joseph & L. Anitha Kumary, 2023). "With the introduction of GST, central excise and service tax were replaced by Central GST (CGST) and Integrated GST (IGST), which are collected and distributed under the framework of the GST Council. As a result, the direct control of the central government over a large part of the tax base has been altered" (PRS India 2023).

In the post-GST era, the central government's tax revenue structure has shifted more heavily towards direct taxes like income tax and corporate tax, while indirect tax revenues now rely significantly on the performance of CGST and the share of IGST. While GST was expected to increase revenues through better compliance and efficiency, the transition has not been without hurdles. The revenue gains initially fell short of projections, especially during economic slowdowns like the COVID-19 pandemic.

Significance of the Study:

The 'implementation of GST' fundamentally altered the revenue structure of both the 'Centre and the states'. By subsuming a host of central indirect taxes into a harmonized GST framework, the central government had to shift its financing strategies. This study helps in analyzing how the composition of tax revenues, particularly the shift from traditional indirect taxes to CGST and IGST, has impacted overall fiscal planning and resource allocation. The study narrates into the GST compensation mechanism, which was introduced to protect states from revenue losses during the transition period. It evaluates how the compensation cess, its collection, and distribution have affected the central government's fiscal management. It give an account on the sustainability and implications of such compensation commitments on central finances. GST has significant implications for fiscal federalism in India. This study explores how the central government's increasing role in tax administration, revenue sharing, and compensation funding has influenced federal cooperation, autonomy of states, and decision-making in the GST Council. Understanding these dynamics is crucial to maintaining cooperative federalism and balanced fiscal governance. The post-GST period has witnessed frequent revenue shortfalls and rising fiscal deficits, particularly during economic downturns. This study assesses how the central government has responded through measures like enhanced borrowing, increased cesses and surcharges, and changes in expenditure priorities. It enables a deeper understanding of the trade-offs and long-term implications of these strategies. It highlights key areas needing reform, such as tax base expansion, compliance enhancement, and fiscal transparency. This serves as a foundation for proposing practical policy recommendations for more stable and equitable central government financing. In essence, this study is capable to unravel the complexities of central government financing in the post-GST era, offering timely the way forward, India's fiscal structure is adapting to a new tax regime. By identifying emerging trends, issues, and challenges, the study aids in building a more transparent, efficient, economic system for the country.

Objectives:

This research article critically examines the evolving landscape of central government finance in the post-GST regime by analyzing trends in revenue generation, expenditure patterns, compensation mechanisms to states, and the implications for fiscal autonomy. The study also highlights emerging issues and challenges, such as revenue shortfalls, compensation cess uncertainties, and intergovernmental tensions

Evolution of Central Government Financing in India:

Since gaining independence in 1947, India has undergone a significant transformation in its approach to central government financing. The financial architecture of the central government has evolved through distinct phases, influenced by the political economy, planning priorities, tax reforms, and federal dynamics (Rao & Singh, 2005). This evolution reflects the country's changing developmental needs, fiscal capacity, and governance models. From a centrally planned economy to a liberalized market-oriented framework and eventually to a "unified indirect tax regime under the Goods and Services Tax (GST)", the journey of central government financing in India reveals the constant balancing act between revenue mobilization, expenditure demands, and cooperative federalism (Bagchi, 2018; Kelkar, 2019).

In the immediate aftermath of independence, the Indian economy was fragile, and public finance was largely guided by colonial legacies. The Constitution of India, adopted in 1950, laid the foundation for a federal fiscal system. It clearly demarcated the division of financial powers between the “Centre and the States” through the Union List, State List, and Concurrent List (Government of India, 1950). “Key sources of revenue such as income tax, customs duties, excise duties, and corporate taxes were assigned to the central government” (Bagchi, A. 2018). The early decades focused on building a strong central fiscal capacity to support national development goals, especially through the mechanism of Five-Year Plans. The Planning Commission played a central role in allocating funds and deciding resource distribution, making central financing largely plan-driven during the 1950s to 1980s (Jha, 1999).

During this period, the central government derived most of its revenues from direct taxes like income and corporate tax, and indirect taxes like central excise and customs. These taxes funded massive investments in infrastructure, industry, and public sector undertakings (RBI, 2011). Borrowings—both internal and external—were used extensively to support capital expenditure. In parallel, Finance Commissions were instituted every five years to recommend principles for revenue sharing between the Centre and States, and to address fiscal imbalances through grants-in-aid (Finance Commission Reports, various years).

The 1991 economic crisis marked a turning point in India’s fiscal policy. Economic liberalization necessitated a shift in central financing strategies. The focus moved from public sector-led growth to private sector participation and market-oriented reforms (Ahluwalia, 2002). “As part of structural adjustments, the central government initiated tax reforms to broaden the tax base, lower tax rates, and simplify procedures. The introduction of service tax in 1994 and reforms in customs and excise created new streams of revenue” (Rao&Tandon, 2011). Simultaneously, efforts were made to control the “fiscal deficit and rationalize government expenditure”. The Fiscal Responsibility and Budget Management (FRBM) Act, passed in 2003, was a major step toward instilling fiscal discipline in central financing (Ministry of Finance, 2004).

In the 2000s, as India's economy expanded rapidly, central revenues increased significantly. Yet, challenges remained due to inefficiencies in the indirect tax system, such as tax cascading, compliance burdens, and fragmented tax jurisdictions across states (Rao, 2017). To address these issues, a major reform was undertaken known as the Goods and Services Tax (GST), implemented in July 2017. This was a landmark moment in the evolution of central government financing. GST replaced multiple indirect taxes levied by the Centre and States with a single tax regime applicable across the country (Government of India, 2017).

Post-GST, the central government’s revenue composition underwent a shift. The traditional excise and service taxes were subsumed under Central GST (CGST), Integrated GST (IGST), and compensation cess. The Centre now shares a significant portion of indirect tax revenue with the states, as determined by the GST Council (15th Finance Commission, 2021). “Although GST aimed to simplify tax administration and improve compliance, its initial years saw revenue volatility. The Centre had to compensate states for revenue shortfalls, placing an added financial burden on the Union exchequer” (CAG, 2020). The COVID-19 pandemic further stressed central finances due to declining tax receipts and increased public spending requirements, leading to high fiscal deficits and borrowing needs (Economic Survey, 2021).

Today, central government financing is marked by a combination of tax revenues (direct and indirect), non-tax revenues (dividends, user charges), capital receipts (disinvestment, loans), and transfers. The Union Budget plays a crucial role in financial planning, resource allocation, and expenditure control (Ministry of Finance, 2023). Despite major reforms, challenges persist in taxation, ensuring compliance, managing public debt, and maintaining fiscal federalism (NITI Aayog, 2022).

Post-GST Trends in Central Government Revenues:

Changing Tax Composition:

‘The share of indirect taxes’ in the central government’s ‘gross tax revenue’ has witnessed a shift. After GST implementation, the central excise collections dropped significantly, and CGST emerged as a vital point in respect of revenue (RBI, 2021). Table 1 (below) shows the trends in tax revenue post-GST.

Year	Gross Tax Revenue (₹ Crore)	CGST (₹ Crore)	Income Tax (₹ Crore)	Corporate Tax (₹ Crore)
2017-18	19,19,183	2,03,261	4,61,023	5,71,202
2018-19	20,80,465	4,57,534	5,61,542	6,63,571
2019-20	20,10,059	4,95,462	5,60,214	5,56,876
2020-21	20,27,104	4,57,534	4,87,144	4,57,719
2021-22	27,07,477	5,91,355	6,93,523	7,12,037

(Source: Union Budget Documents; RBI, 2022)

GST Compensation Cess:

One key feature of GST was the promise of compensation to states for a period of five years (2017–22) for any revenue loss. The compensation cess collected on luxury and sin goods was to be distributed to states accordingly. However, during the COVID-19 pandemic, the economic slowdown led to reduced GST collections, making it difficult for the central government to honor compensation commitments on time (15th Finance Commission, 2021).

Key Issues in Central Government Financing Post-GST:

Revenue Shortfall and Fiscal Deficit: One of the biggest issues faced by the central government has been consistent revenue shortfalls. Despite increased GST compliance, revenues have not consistently met projections. The shortfall has forced the government to rely more heavily on borrowings, increasing the fiscal deficit. For instance, the fiscal deficit for 2020–21 stood at 9.2% of GDP, a sharp rise from pre-GST years (Economic Survey, 2021).

Uncertainty around Compensation Mechanism: The five-year GST compensation window ended in June 2022. States have since demanded an extension, citing continued revenue challenges. The central government’s reluctance to extend the compensation period indefinitely has created fiscal friction. This also impacts cooperative federalism and trust between the Centre and states (Rao & Mukherjee, 2022).

Centralization of Revenue Powers: Some states have expressed concern over the increasing centralization of fiscal powers post-GST. With the GST Council largely determining indirect tax policy, and the central government administering CGST and IGST, states feel that their fiscal autonomy has been eroded (Bagchi, 2018). This is particularly critical for states with high dependence on indirect taxes.

Impact of COVID-19 Pandemic: The COVID-19 pandemic severely impacted GST collections and overall economic activity. The Centre had to borrow funds on behalf of states to bridge the GST compensation gap. This created an unsustainable debt burden and stressed the union budget (Ministry of Finance, 2021).

Challenges Ahead:

Enhancing GST Compliance: To boost revenues, the central government must focus on increasing compliance through robust digital infrastructure, audit mechanisms, and taxpayer education. Simplifying the GST structure by reducing slabs and removing exemptions could also help (NITI Aayog, 2022).

Reforms in Fiscal Transfers: The central government's financing strategy must be supported by efficient devolution of funds to states. Future Finance Commissions should propose flexible yet equitable sharing models to address vertical and horizontal fiscal imbalances (15th Finance Commission, 2021).

Reassessing the Compensation Framework: There is a growing demand for a restructured compensation framework that is transparent, predictable, and long-term. This is necessary to maintain the federal compact and support developmental goals, especially for fiscally weaker states (Reddy, 2022).

Managing the Debt Burden: The central government must work on reducing its reliance on borrowings to finance deficits. Strategies such as disinvestment, privatization of PSUs, and tapping non-tax revenues must be strengthened (Economic Survey, 2022).

Recommendations:

- **Revamp GST Council Functions:** Ensure greater representation and consensus-building mechanisms to enhance the credibility of GST decisions.
- **Expand Tax Base:** Include sectors like petroleum and real estate under GST ambit to widen the tax net.
- **Transparency in Compensation:** Regular disclosures on cess collections and disbursements to maintain intergovernmental trust.
- **Improve Data Analytics:** Use of AI and big data analytics for better tax tracking and fraud detection.

Conclusion:

The post-GST era in India has redefined central government financing, presenting both opportunities and challenges. While GST has streamlined taxation and increased transparency, it has also exposed revenue vulnerabilities and created new fiscal stresses. The central government must navigate this complex landscape by ensuring cooperative federalism, rationalizing its expenditure, and adopting progressive reforms in fiscal management. Only through a balanced and collaborative approach can India sustain its developmental goals while maintaining macroeconomic stability.

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