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Abstract

Given the ongoing shortfall in GST collection and uncertainty associated with revenue on account of SGST collection, many states have approached the Fifteenth Finance Commission (FFC) for possible extension of the GST compensation period by another three years, i.e., up to 2024-25. Since the decision on possible extension of the GST compensation period is yet to be taken, it is important to assess possible impact of withdrawal of GST compensation beyond the transition period, i.e., beyond 30 June 2022, on Indian state finances. Any shock to state finances due to withdrawal of GST compensation after the GST transition period may have profound impact on India's fiscal management and therefore macroeconomic stability. Since such impact assessment has not been carried out in Indian public finance literature yet, the present paper attempts to fill the gap.

Even if the GST compensation period is extended beyond 30 June 2022, union government may not have adequate fiscal space to provide GST compensation to states at the ongoing annual growth rate of 14 percent, unless either tax buoyancy and/or nominal growth rate of GDP improves. Exploring a possible design of GST Compensation Cess may help the governments to reduce uncertainty (arbitrariness) in setting the growth rate of revenue protection and also provide inducement to states to put additional tax efforts to augment GST collection. Moreover, given the uncertainties associated with GST collection and possible recovery of Indian economy from the ongoing slowdown, a suitable design of GSTCC may release stress from the union finances on account of GST compensation payment obligation.

Key Words: Goods and Services Tax (GST), GST Compensation Cess, Revenue Protection, Fiscal Stress, Tax Design, Indian State Finances.

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1. Introduction

The Goods and Services Tax (Compensation to States) Act, 2017 (hereafter referred as GST Compensation Act) has assured states to protect revenue during the first five years of GST introduction (also known as transition period). For individual states, revenue on account of state GST (SGST) collection (including Integrated GST settlement) will be protected during the transition period. According to the GST Compensation Act, states will receive GST compensation in case actual SGST collection falls short of projected SGST collection. The projection of SGST revenue is based on annual growth rate of 14 percent with reference to net collection of taxes subsumed under GST in 2015-16 (also known as Revenue Under Protection or RUP in GST). Since GST is introduced in India on 1 July 2017, it is expected that states will continue to receive GST compensation till 30 June 2022. To provide GST compensation to states, GST Compensation Cess (GSTCC) is introduced along with GST on some specific items to mobilize resources for the GST Compensation Fund. The union government manages the fund.

Given the ongoing shortfall in overall GST collection as well as rising revenue gap between GST compensation requirement and GSTCC mobilization, timely release of GST compensation has become a matter of contention between the union and state governments. There is also discussion on possible reduction of growth rate in projecting states' RUP during the transition period, given the ongoing fall in economic growth in India. The shortfall in GSTCC collection vis-à-vis GST compensation requirement and possible fiscal mechanism for compensating states is an emerging challenge. It is surprising to note that in the GST Compensation Act, no guidelines are provided on possible mechanism to compensate states in case GSTCC collection falls short of GST compensation requirement. It is expected that, if one goes by the realm of the Act, providing GST compensation to states is the responsibility of the union government during the GST transition period.

The GST Compensation Act (also referred here as Principal Act) deals with the surplus on account of GSTCC collection in Section 10(3) and make provisions for sharing the surplus between union and state governments by the following mechanism:

> "Fifty per cent of the amount remaining unutilised in the Fund [GST Compensation Fund] at the end of the transition period shall be transferred to the Consolidated Fund of India as the share of Centre, and the balance fifty per cent shall be distributed amongst the States in the ratio of their total revenues from the State tax or the Union territory goods and services tax, as the case may be, in the last year of the transition period." (Section 10(3) of the GST Compensation Act)

This provision of the Principal Act has been amended by the Goods and Services Tax (Compensation to States) Amendment Act 2018 (hereafter referred as Amendment Act) by inserting the following sub-section:

> "(3A) Notwithstanding anything contained in sub-section (3), fifty per cent of such amount, as may be recommended by the Council, which remains unutilised in the

Fund, at any point of time in any financial year during the transition period shall be transferred to the Consolidated Fund of India as the share of Centre, and the balance fifty per cent shall be distributed amongst the States in the ratio of their base year revenue determined in accordance with the provisions of section 5:

Provided that in case of shortfall in the amount collected in the Fund against the requirement of compensation to be released under section 7 for any two months' period, fifty per cent of the same, but not exceeding the total amount transferred to the Centre and the States as recommended by the Council, shall be recovered from the Centre and the balance fifty per cent from the States in the ratio of their base year revenue determined in accordance with the provisions of section 5.".

According to the Amendment Act, in case of shortfall in GSTCC collection vis-à-vis GST compensation requirement, the earlier distributed surpluses (balance between collection and disbursement of GST compensation) may be recovered from the union as well as state governments to pay current GST compensations to states. Table 1 shows that possibly there is accumulated surplus of Rs. 49,564 Crore in the GST Compensation Fund from 2017-18 and 2018-19, which may be recovered and used to pay current year's GST compensation.

Table 1: GSTCC Collection, Disbursement and Balance (Rs. Crore)

	2017-18		
	Collection (A)	**Release (B)**	**Balance (A-B)**
July & Aug 2017	7,749	10,805	-3,056
Sept & Oct 2017	16,056	13,694	2,362
Nov & Dec 2017	15,025	3,898	11,127
Jan & Feb 2018	16,266	13,085	3,181
Mar 2018	7,520	6,696	824
Total	**62,616**	**48,178**	**14,438**
	2018-19		
	Collection (A)	Release (B)	Balance (A-B)
Apr & May 2018	15,893	3,899	11,994
Jun & Jul 2018	16,484	14,930	1,554
Aug & Sept 2018	15,621	11,922	3,699
Oct & Nov 2018	16,031	2,000	14,031
Dec & Jan 2018	16,578	15,693	885
Feb & Mar 2018	16,762	13,799	2,963
Total	**97,369**	**62,243**	**35,126**
	2019-20		
	Collection (A)	Release (B)	Balance (A-B)
Apr & May 2019	17,293	17,789	-496
Jun & Jul 2019	15,730	27,955	-12,225
Aug & Sept 2019	15,227		

Oct 2019	7,727		
Dec 2019		35,298	
Total	**55,977**	**81,042**	**-12,721**

Source: Compiled from Press Information Bureau (PIB)'s Monthly Press Releases and Website of GST Council

Given the ongoing shortfall in GST collection and uncertainty associated with revenue on account of SGST collection, many states have approached the Fifteenth Finance Commission (FFC) for possible extension of the GST compensation period by another three years, that is, up to 2024-25 (Jha 2019). Though the decision on extension of the GST compensation period is ceremonially vested on the GST Council, *de facto* it will depend on the decision of the union government. Since the decision on possible extension of the GST compensation period is yet to be taken, it is important to assess possible impact of withdrawal GST compensation beyond the transition period, i.e., beyond 30 June 2022, on Indian state finances. Clarity on possible fate of GST compensation period after the transition period may help state governments to plan their expenditures accordingly. Any shock to state finances due to sudden withdrawal of GST compensation after the GST transition period may have profound impact on India's fiscal management and therefore macroeconomic stability. Since such impact assessment has not been carried out in Indian public finance literature yet, the present paper attempts to fill the gap.

1.1 Possible Designs of GST Compensation Cess beyond the GST Compensation Period

According to the Section 8(1) of the Goods and Services (Compensation to States) Act 2017, the fate of the Compensation period vested on the decision of the GST Council but any decision on extension of the GST compensation period will depend on the Union government.

> "the purposes of providing compensation to the States for loss of revenue arising on account of implementation of the goods and services tax with effect from the date from which the provisions of the Central Goods and Services Tax Act is brought into force, for a period of five years or for such period as may be prescribed on the recommendations of the Council:" (Section 8(1) of the Goods and Services (Compensation to States) Act 2017)

Even if the GST compensation period is extended beyond the transition period, it is unlikely that the GST compensation will continue in the present rate for the period of extension. Union government may not have adequate fiscal space to provide GST compensation to states at the ongoing annual nominal growth rate of 14 percent, unless either tax buoyancy and/or nominal growth rate of GDP improves.[1] Exploring possible designs of GSTCC may help the governments to reduce uncertainty (arbitrariness) in setting the growth rate of revenue protection and also provide inducement to states to put additional tax efforts to augment GST collection. Moreover, given the uncertainties associated with GST

[1] Tax buoyancy is ratio of growth rate of tax collection and growth rate of Gross Domestic Product (GDP) or Gross Value Added (GVA).

collection and possible recovery of Indian economy from the ongoing slowdown, a suitable design of GSTCC may release stress from the union finances on account of GST compensation payment obligations. Such design of GSTCC could also help to reduce tension between the union and state governments arising due to delay in payment of GST compensation.

If the GSTCC continues like other cesses of the union government, the net proceeds of the GSTCC will be the sole revenue of the union government alone and there will be no share receivable by the States. If GSTCC is subsumed under the GST as an additional tax (with provision for input tax credit) on top of the prevailing GST rate, possibly there will be two alternative designs of GSTCC – GSTCC as a central tax and it will be levied on the consolidated tax base of central GST (CGST) and state GST (SGST) or as concurrent tax where the union government will levy the central part of GSTCC on CGST and state governments will levy state part of GSTCC on SGST. Design of GSTCC as a concurrent tax may also pave the way for inclusion of out-of-GST petroleum products (petrol, diesel, ATF), natural gas and crude petroleum under GST where the union and state governments may decide to levy additional tax on top of the desired CGST and SGST rates to achieve respective revenue neutrality (Mukherjee and Rao 2015, Mukherjee 2019a). If GSTCC is levied as central tax, like any other central taxes, states will receive share of net proceeds (net of cost of collection and refunds) of GSTCC as per the Finance Commission's tax devolution formula. Alternatively if GSTCC is designed as a concurrent tax like GST, net proceeds of the state part of GSTCC will be accrued to states and also states will receive share in central part of GSTCC as per the Finance Commission's tax devolution formula. Among the three alternative designs of GSTCC, for states the best design would be GSTCC as concurrent tax. In the present paper, we have captured the possible revenue implications to state finances as per the alternative designs of GSTCC. Ongoing shortfall in GST collection may constrain the GST Council to opt for complete withdrawal (revocation) of GSTCC post GST Compensation period, and therefore we have not dealt with this option in the present paper.

In the next section we present revenue importance of state taxes subsumed under GST in state finances in India. We also present expected state-wise RUP for the year 2021-22 and 2022-23 based on RUP of 2015-16. Following Mukherjee and Rao (2019), we present projected collection of GST, SGST (including Ingratiated GST settlement) and GSTCC in section 3. In section 4, we present the expected GST compensation requirement based on projected SGST collection and RUP in GST for 2021-22 and 2022-23. We also estimate the gap between expected GST compensation requirement and projected GSTCC collection in this section. We develop two alternative scenarios of GST compensation payment - Full Compensation (FC) if the GST compensation period is extended to cover full financial year of 2022-23 and Partial Compensation (PC) if the GST compensation period ends on 30 June 2022 - and estimate the revenue gap between the scenarios. To understand the impact of the revenue gap on state finances, we present the revenue gap as percentage of expected SGST collection (including IGST settlement but excluding GST Compensation) in the year 2022-23. In section 5, we explore alternative designs of GSTCC and estimate the expected benefits to states. We draw our conclusions in section 6.

2. Revenue under Protection (RUP) in the GST Regime and Importance of GST in State Finances

Revenue importance of taxes subsumed under GST (i.e., RUP) varies across states and on average it used to contribute one-fifth of total revenue receipts for major states in 2015-16 (Table 2).[2] On average RUP used to contribute 46 percent of own tax revenue and finance 18 percent of total expenditure (excluding loans and advances) for major states. The revenue importance of GST basket of revenue is much higher for minor states with specific to own tax revenue mobilization.

Table 2: Revenue Importance of GST in State Finances during 2015-16

Description	**Major States**			**Minor States#**		
	Average	Minimum	Maximum	Average	Minimum	Maximum
RUP as Percentage of **Total Revenue Receipts** (%)	21.9	13.1	34.9	9.3	2.4	23.4
RUP as Percentage of **Total Tax Revenue** (%)	29.1	17.0	41.8	17.5	3.4	35.3
RUP as Percentage of **Own Tax Revenue** (%)	45.5	34.8	55.8	56.1	43.2	65.0
RUP as Percentage of **Comprehensive VAT** (%)*	70.1	47.7	91.3	79.7	74.1	91.0
RUP as Percentage of **Total Expenditure** (%)**	18.2	11.7	28.4	8.4	2.5	18.2
RUP as Percentage of **Revenue Expenditure** (%)	21.3	14.5	31.8	9.9	3.1	21.5

Notes: *-includes Sales Tax/ VAT, Central Sales Tax (CST), and Entry Tax, **- excluding Loans and Advances, # - minor states are North Eastern and Hilly States (including Jammu & Kashmir).
Source: Rajya Sabha Starred Question No. -*164, Answered on 3 December 2019 and Finance Accounts of the respective state governments

Given the revenue importance of taxes subsumed under GST in state finances, the assurance of revenue protection given by the union government helped to achieve broad consensus in favour of GST. Unlike the union government, states have limited taxation power (tax handles) to generate additional revenue to cope up with any major revenue shortfall on account of GST collection. Therefore the revenue protection enshrined under the GST Compensation Act has played an important role to minimise revenue uncertainty associated with GST reform and motivated states in favour of introduction of GST. This has also helped the GST Council to experiment with design, structure and administrative provisions of the

[2] RUP includes state taxes subsumed under GST, viz., VAT, CST, Tax on works contract, Entertainment Tax, Lottery, Betting and Gambling Tax, Luxury Tax, Entry Tax not in lieu of Octroi, Entry Tax in lieu of Octroi/ Octroi/local body tax, Cesses and Surcharges, Advertisement Tax, Purchase Tax and ITC Reversal.

GST during the transition period to moderate the impact of GST on Indian economy as well as facilitate ease of tax compliance. Barring a few states (e.g., Bihar, Chhattisgarh), most states do not have the capacity to achieve 14 percent growth rate in taxes subsumed under GST and therefore, the assurance of revenue protection provides a comfortable fiscal space to states to cope up with the GST system (Mukherjee 2019b). Withdrawal of GST compensation post GST transition period may result in substantial fiscal shock to State finances in India. The impact of withdrawal of GST compensation (post GST compensation period) on state finances will differ across states and states having higher importance on the GST basket of revenue are expected to face the maximum shock.

Based on data available in the public domain, state-wise RUP is presented for 2022-23, i.e., the terminal year of the transition period, in Table 3.

Table 3: State-wise Revenue Under Protection (RUP) in GST for 2022-23 (Rs. Crore)

Name of State/UT	2015-16	2021-22*	2022-23*	
			Annual	Monthly#
Major States				
Andhra Pradesh	13,873	30,452	34,715	2,893
Bihar	12,621	27,702	31,580	2,632
Chhattisgarh	7,357	16,148	18,409	1,534
Goa	2,181	4,788	5,458	455
Gujarat	28,856	63,339	72,206	6,017
Haryana	15,231	33,431	38,111	3,176
Jharkhand	6,411	14,071	16,041	1,337
Karnataka	36,144	79,335	90,442	7,537
Kerala	16,821	36,922	42,092	3,508
Madhya Pradesh	15,329	33,647	38,358	3,196
Maharashtra	60,505	1,32,806	1,51,399	12,617
Odisha	11,049	24,253	27,648	2,304
Punjab	14,472	31,765	36,212	3,018
Rajasthan	17,159	37,663	42,935	3,578
Tamil Nadu	29,786	65,380	74,533	6,211
Telangana	16,109	35,358	40,308	3,359
Uttar Pradesh	33,388	73,285	83,545	6,962
West Bengal	20,098	44,114	50,290	4,191
Minor States				
Arunachal Pradesh	256	562	641	53
Assam	5,986	13,138	14,977	1,248
Himachal Pradesh	3,634	7,977	9,094	758
Jammu and Kashmir	4,766	10,462	11,927	994
Manipur	347	762	868	72
Meghalaya	636	1,396	1,592	133

Mizoram	189	415	473	39
Nagaland	256	562	641	53
Sikkim	245	539	614	51
Tripura	789	1,731	1,974	164
Uttarakhand	4,961	10,890	12,414	1,035
UTs with Legislative Assembly				-
Delhi	16,784	36,841	41,998	3,500
Puducherry	1,095	2,404	2,741	228

Notes: *- Estimated Revenue Under Protection $(ERUP)^t$ = Revenue Under Protection for 2015-16*$(1.14)^t$, where t=6 for 2021-22 and t=7 for 2022-23. #-Monthly RUP is estimated based on the assumption that annual tax collection is equally distributed across months and there is no bunching of tax payments.
Source: *Rajya Sabha Starred Question No. -*164*, Answered on 3 December 2019.

3. Projection of State GST Collection

Mukherjee and Rao (2019) projects GST collection for the period 2019-20 to 2024-25 based on actual GST collection during Q3:2017-18 to Q2:2018-19 and projected growth rate in Gross Value Addition (GVA) in basic prices (2011-12 Series, Current Prices). The study estimates average tax (GST) - GVA ratio for the period Q3:2017-18 to Q2:2018-19 and assumes that GST-GVA ratio will remain unchanged for the period 2019-25. In other words, the study assumes that tax buoyancy will remain constant at 1 for the period 2019-25 in a baseline scenario. However, the study has also projected GST revenue under several alternative scenarios where scenarios are built based on different assumptions on tax buoyancy as well as alternative data sources (viz., GST Network (GSTN) and Department of Revenue (DoR) of Ministry of Finance).[3] The study relies on International Monetary Fund (IMF)'s projection of India's real GDP growth rate and Consumer Price Index (CPI) based inflation projection as available in the *World Economic Outlook – April 2019* (IMF 2019). Mukherjee and Rao (2019) projects GST collection for all India with and without collection of revenue on account of GSTCC and assigns the shares of the union and state governments based on actual collection of CGST and SGST post IGST settelement (both regular and ad hoc) respectively for the period Q3:2017-18 to Q2:2018-19 (Table 4). The study assigns 52 percent (as observed during April 2018 to May 2019) of total GST collection (excluding collection on account of GSTCC) as states' share and it assumes that during 2019-25, the share

[3]Mukherjee and Rao (2019) has identified problems associated with reconciliation of GST data across databases and concludes that "Department of Revenue (DoR) releases monthly statement of GST collection under different heads based on data obtained from GSTN, Indian Customs (ICES - Indian Customs EDI System) and IGST settlement (regular and ad hoc) while the coverage of data provided by GSTN is narrower. All of these together mean that these data series cannot be combined to construct a consistent and comprehensive data set on revenues from GST." Moreover, the data released by DoR relates to the actual collection in any given month, irrespective of which filing period it refers to while the data from GSTN provides information based on the filing period it is related to.

will remain constant. The study also separetely projects revenue on account of GSTCC collection and compares the same with expected requirement of GST compensation based on 14 percent nomional annual growth rate in states' RUP with reference to 2015-16. For projection of GSTCC collection same set of assumptions are followed as in the case of GST collection. In line with GST collection, for projection of GSTCC collection alternative tax buoyancy estimates are also presented in the study (Table 5). Four alternative tax bauoyancy based estimations are presented by Mukherjee and Rao (2019), but due to space constraints, we present two alternative tax buoyancy based estimates in this paper.

Table 4: GST Revenue Projection for 2019-20 to 2024-25 (Rs. Crore)

Expected Tax Buoyancy	0.9				1.0			
GST Revenue Projection	GSTN-without GSTCC		DoR-without GSTCC		GSTN-without GSTCC		DoR-without GSTCC	
FY	Annual	Average - Monthly	Annual	Average - Monthly	Annual	Average - Monthly	Annual	Average - Monthly
2019-20	1,185,700	98,808	1,155,727	96,311	1,197,174	99,765	1,166,911	97,243
2020-21	1,317,849	109,821	1,284,536	107,045	1,331,257	110,938	1,297,605	108,134
2021-22	1,471,439	122,620	1,434,243	119,520	1,487,015	123,918	1,449,425	120,785
2022-23	1,646,274	137,189	1,604,658	133,722	1,663,969	138,664	1,621,906	135,159
2023-24	1,842,180	153,515	1,795,613	149,634	1,861,982	155,165	1,814,913	151,243
2024-25	2,059,724	171,644	2,007,657	167,305	2,081,696	173,475	2,029,073	169,089
SGST Revenue Projection*								
2019-20	616,564	51,380	600,978	50,082	622,530	51,878	606,794	50,566
2020-21	685,282	57,107	667,959	55,663	692,254	57,688	674,755	56,230
2021-22	765,148	63,762	745,806	62,151	773,248	64,437	753,701	62,808
2022-23	856,062	71,339	834,422	69,535	865,264	72,105	843,391	70,283
2023-24	957,934	79,828	933,719	77,810	968,231	80,686	943,755	78,646
2024-25	1,071,057	89,255	1,043,982	86,998	1,082,482	90,207	1,055,118	87,926

Note: *-States' share in total GST collection is 52 percent (as observed during April 2018 to May 2019) and it is assumed that during 2019-25, the share will remain constant.
Source: Compiled from Mukherjee and Rao (2019)

Table 5: projected GST Compensation Cess Collection (Rs. Crore)

Tax Buoyancy	1.00	0.90
2019-20	112,085	111,010
2020-21	124,638	123,383
2021-22	139,221	137,763
2022-23	155,788	154,131
2023-24	174,327	172,473
2024-25	194,898	192,840

Source: Compiled from Mukherjee and Rao (2019)

Based on data presented in Mukherjee and Rao (2019), state category-wise projected SGST collection (including IGST settelement and excluding GST compensation recepits) is presented in Table 6 under two alternative tax buoyancy scenarios and accrosss data sources. Table 6 shows that with falling tax buoyancy GST revenue collection falls and tax collection with respect to GSTN database is higher than DoR database. For 10 percentage point change in tax buoyancy, on average GST collection changes by 1.1 percent, given asssumption on growth rate of GVA. This shows that any change in tax buoyancy and/or growth rate of GVA, will result in variability in GST collection and therfroe substantial revenue unceratinty for governments.

Table 6: State Category-wise Expected Collection of State GST (including IGST Settlement and excluding GSTCC) (Rs. Crore)[4]

Tax Buoyancy	Data Source	Year	Major States	Minor States	UTs with Legislative Assembly	Total
1.00	GSTN	2021-22	7,00,127	38,955	30,218	7,69,301
		2022-23	7,83,442	43,591	33,814	8,60,847
	DoR	2021-22	6,82,429	37,970	29,454	7,49,854
		2022-23	7,63,638	42,489	32,959	8,39,086
0.90	GSTN	2021-22	6,92,794	38,547	29,902	7,61,243
		2022-23	7,75,111	43,127	33,455	8,51,693
	DoR	2021-22	6,75,281	37,573	29,146	7,41,999
		2022-23	7,55,517	42,037	32,609	8,30,163

Source: Compiled from Mukherjee and Rao (2019)

[4] Numbers presented in tables hereafter are based on state-wise analysis/ estimates, however due to space constraints; state-wise analysis is not presented in the paper.

4. Estimation of GST Compensation Requirement

State-wise revenue gap between expected SGST collection and RUP determines the expected GST compensation requirement and it is presented in Table 7 across state categories. It shows that in 2021-22 the expected GST compensation requirement would vary between Rs. 104,485 crore to Rs. 130,845 crore, depending on tax buoyancy and reliability of data sources. Table 7 also shows that for 10 percentage point fall in tax buoyancy, on average GST compensation requirement increases by 7 percent (with reference to GSTN database). For all States, GST compensation requirement goes up in 2022-23 as compared to 2021-22. If tax buoyancy falls the compensation requirement will rise.

Table 7: State-wise Expected GST Compensation Requirement for the Respective Financial Year (Rs. Crore)

Tax Buoyancy	Data Source		Major States	Minor States	UTs with Legislative Assembly	Total
1.00	GSTN	2021-22	85,144	10,314	9,027	1,04,485
		2022-23	1,10,842	12,499	10,925	1,34,266
	DoR	2021-22	1,02,031	11,206	9,791	1,23,028
		2022-23	1,30,646	13,497	11,780	1,55,924
0.90	GSTN	2021-22	91,780	10,684	9,343	1,11,807
		2022-23	1,19,174	12,919	11,285	1,43,377
	DoR	2021-22	1,09,179	11,566	10,099	1,30,845
		2022-23	1,38,767	13,906	12,130	1,64,804

Source: Compiled from Mukherjee and Rao (2019)

The revenue gap between estimated GSTCC collection and GST compensation requirement is presented in Table 8. It shows that with falling tax buoyancy GST compensation requirement will rise and at the same time GSTCC collection will fall which may further aggravate the tension between union and state governments on account of timely release of GST compensation to states.

Table 8: GSTCC Collection vis-à-vis GST Compensation Requirement across Tax Buoyancy Based Scenarios (Rs. Crore)

Alternative Database=>	State Category	GSTN			DoR		
FY		**Total GST Compensation Required*(A)**	**GST Compensation Cess Collection (B)**	**Gap (B-A)**	**Total GST Compensation Required* (C)**	**GST Compensation Cess Collection (D)**	**Gap (D-C)**
2021-22	Major States	85,144			1,02,031		
	Minor States	10,314			11,206		
	UTs with LA	9,027			9,791		
	Total	**1,04,485**	**1,39,221**	**34,736**	**1,23,028**	**1,39,221**	**16,193**
2022-23	Major States	1,10,842			1,30,646		
	Minor States	12,499			13,497		
	UTs with LA	10,925			11,780		
	Total	**1,34,266**	**1,55,788**	**21,522**	**1,55,924**	**1,55,788**	**-136**
Tax Buoyancy		**0.9**					
2021-22	Major States	91,780			1,09,179		
	Minor States	10,684			11,566		
	UTs with LA	9,343			10,099		
	Total	**1,11,807**	**1,37,763**	**25,956**	**1,30,845**	**1,37,763**	**6,918**
2022-23	Major States	1,19,174			1,38,767		
	Minor States	12,919			13,906		
	UTs with LA	11,285			12,130		
	Total	**1,43,377**	**1,54,131**	**10,754**	**1,64,804**	**1,54,131**	**-10,673**

Source: Compiled from Mukherjee and Rao (2019)

According to GST Compensation Act, states will receive GST compensation during the transition period which is the first five years of GST implementation, i.e., during 1 July 2017 to 30 June 2022. If GST compensation ends on 31 March 2023, the expected SGST collection with GST compensation is presented in Table 8. In other words, if states receive full GST compensation for the Financial Year (FY) of 2022-23, the expected revenue profile of states by categories is presented in Table 8. We have termed this scenario as Full Compensation (FC) Scenario.

Table 8: State Category-wise Expected SGST Collection with GST Compensation till 31 March 2023 (under Full Compensation, FC) (Rs. Crore)

Tax Buoyancy	Data Source	Year	Major States	Minor States	UTs with Legislative Assembly	Total
1.00	GSTN	2021-22	7,85,272	49,270	39,245	8,73,786
		2022-23	8,94,284	56,090	44,739	9,95,114
	DoR	2021-22	7,84,460	49,177	39,245	8,72,882
		2022-23	8,94,284	55,986	44,739	9,95,010
0.90	GSTN	2021-22	7,84,574	49,231	39,245	8,73,050
		2022-23	8,94,284	56,046	44,739	9,95,070
	DoR	2021-22	7,84,460	49,139	39,245	8,72,844
		2022-23	8,94,284	55,944	44,739	9,94,967

Source: Estimated

In case if the GST compensation is not extended beyond 30 June 2022 for the FY 2022-23, the expected revenue profile of states by categories with respect to SGST collection is presented in Table 9. In this scenario, we have divided annual GST collection and compensation requirement into 12 equal monthly tranches for 2022-23. Here our assumption is that SGST collection would be equal across months and there will be no bunching of tax payments. For the Q1 of 2022-23 (April 2022 – June 2022), state-wise SGST revenue will comprise of expected SGST collection (including IGST settlement) and GST compensation receipts and for the other 3 quarters (Q2- Q3) of 2022-23 we have considered only expected SGST collection (including IGST settlement) without GST compensation. In other words, during Q2 to Q4 of 2022-23, states will not receive GST compensation on account of shortfall in SGST collection from the projected SGST revenue. We have termed this scenario as Partial Compensation (PC) Scenario.

Table 9: State Category-wise Expected SGST Collection with GST Compensation till 30 June 2022 (under Partial Compensation, PC) (Rs. Crore)

Tax Buoyancy	Data Base	Major States	Minor States	UTs with Legislative Assembly	Total
1.00	GSTN	8,11,153	46,716	36,546	8,94,414
	DoR	7,96,300	45,863	35,904	8,78,067
0.90	GSTN	8,04,904	46,357	36,276	8,87,537
	DoR	7,90,209	45,514	35,642	8,71,364

Source: Estimated

Table 10 shows that if GST compensation is withdrawn after 30 June 2022, consolidated revenue gap of states would vary between Rs. 100,700 crore to 123,646 crore depending on expected tax buoyancy and reliability of data sources. This implies that states will need to either generate an equivalent amount of revenue from exiting sources to continue with committed expenditures and/or cut back expenditures to cope up with the revenue shock in 2022-23.

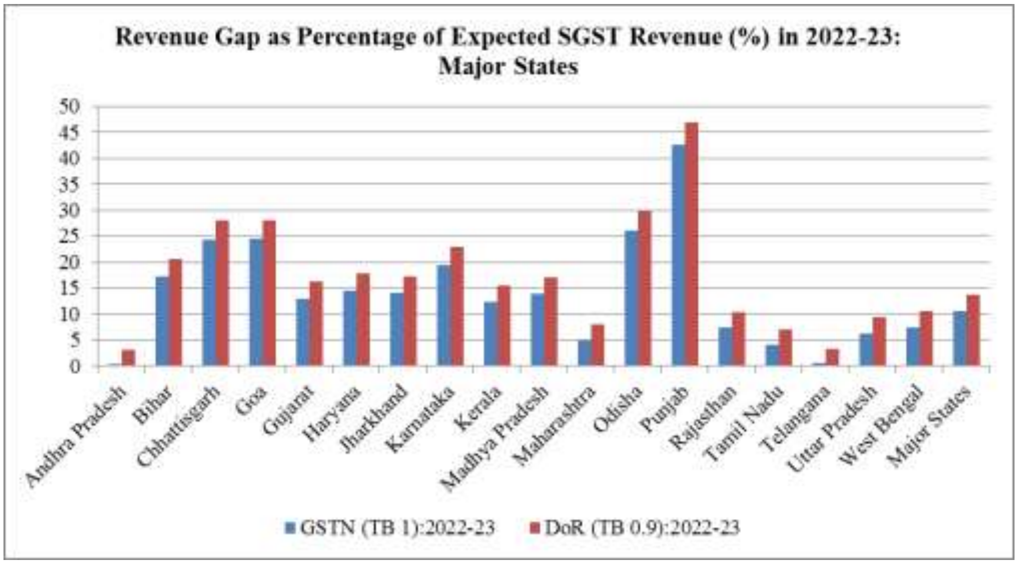
Table 10: State Category-wise Revenue Gap due to Withdrawal of GST Compensation on 30 June 2022

Tax Buoyancy	**1.00**					
Data Source	GSTN			DoR		
GST Compensation Scenario	FC	PC	Gap (FC-PC)	FC	PC	Gap (FC-PC)
Major States	8,94,284	8,11,153	83,132	8,94,284	7,90,209	1,04,076
Minor States	56,090	46,716	9,374	55,986	45,514	10,472
UTs with LA	44,739	36,546	8,194	44,739	35,642	9,098
Total	**9,95,114**	**8,94,414**	**1,00,700**	**9,95,010**	**8,71,364**	**1,23,646**
Tax Buoyancy	**0.9**					
Major States	8,94,284	8,04,904	89,380	8,94,284	7,90,209	1,04,076
Minor States	56,046	46,357	9,689	55,944	45,514	10,430
UTs with LA	44,739	36,276	8,464	44,739	35,642	9,098
Total	**9,95,070**	**8,87,537**	**1,07,533**	**9,94,967**	**8,71,364**	**1,23,603**

Notes: FC stands for Full GST Compensation till 31 March 2023 for the FY2022-23. PC stands for Partial GST Compensation and it means GST Compensation till 30 June 2022 for FY2022-23.
Source: Estimated

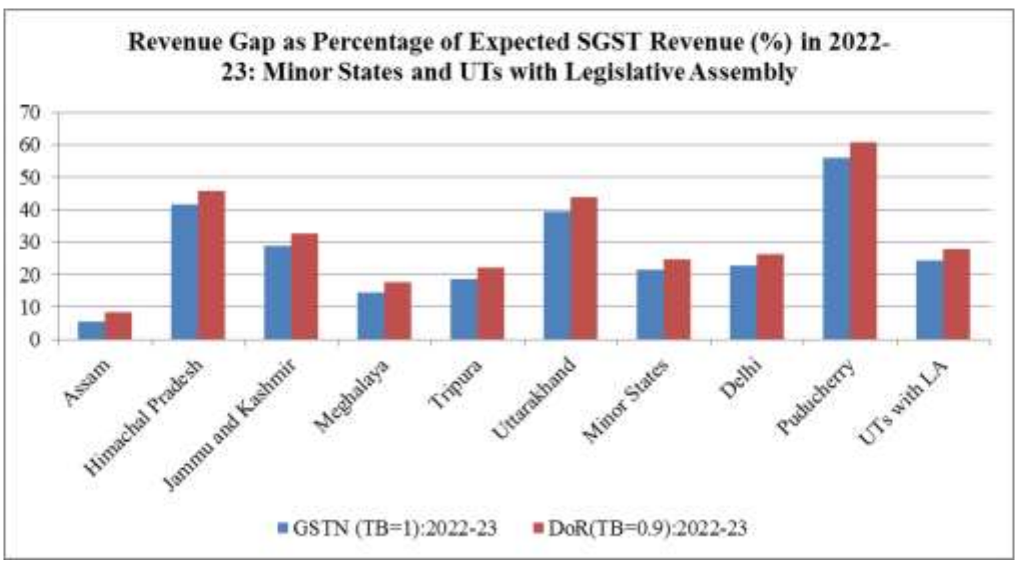
We have presented the state-wise revenue gap as percentage of expected SGST collection (including IGST settlement but excluding GST compensation) in 2022-23 in Figure 1-2. Figure 1 shows that for major states average revenue gap will vary between 11-14 percent depending on tax buoyancy and data sources. This implies that on average major states need to mobilize additional 11-14 percent of the projected SGST collection to compensate revenue loss on account of withdrawal of GST compensation payment beyond 30 June 2022. The withdrawal of GST compensation and fall in overall SGST collection will have substantial impact on state finances of Punjab, Odisha, Goa, Chhattisgarh and Karnataka among major states (Figure 1). Among minor states, substantial revenue gap will be for Himachal Pradesh, Uttarakhand, Tripura and Meghalaya (Figure 2).

Figure 1: Expected State-wise Revenue Gap in State GST with respect to Expected SGST Collection in 2022-23 – Major States (%)



Source: Computed

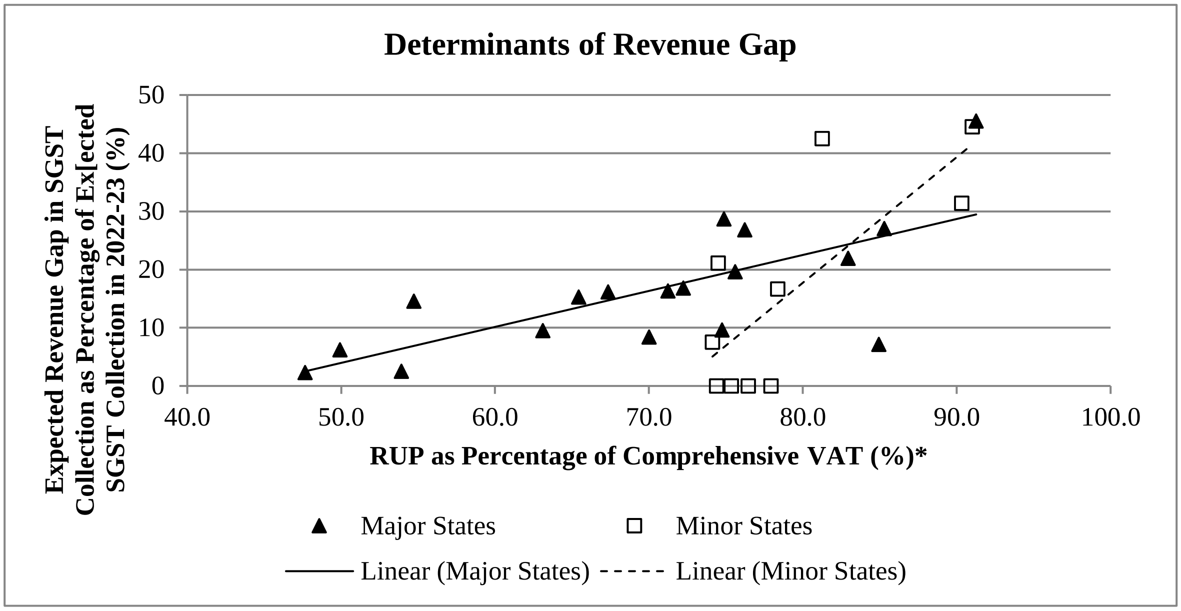
Figure 2: Expected State-wise Revenue Gap in State GST with respect to Expected SGST Collection in 2022-23 – Minor States (%)



Source: Computed

The impact of withdrawal of GST compensation on state finances will vary across states depending on state's expected fall in revenue receipts on account of withdrawal of GST compensation and importance of GST revenue in overall comprehensive VAT collection (including sales tax/ VAT, entry tax, CST) in 2015-16 (Figure 3). Figure 3 shows that states having higher dependence on the revenue basket that is subsumed under GST in 2015-16 will face larger shortage of revenue from withdrawal of GST compensation beyond 30 June 2022.

Figure 3: Determinants of Revenue Gap



Note: *-Comprehensive VAT includes sales tax/ VAT, CST, and entry tax
Source: Computed

5. Possible Designs of GST Compensation Cess beyond GST Compensation Period

We have explored two alternative designs of GSTCC for the post GST compensation period in this section. The first, possible design could be "GSTCC as a Central Tax" and it would be levied by the union government at the prevailing rate on the existing tax base of GST (comprising of CGST and SGST) on goods already identified and attracting GSTCC. In this design, a part of the net tax proceeds of GSTCC collection will be shared with states as per the tax devolution formula of the Finance Commission. The share of states in central taxes during 2020-21 to 2024-25 will be guided by the recommendation of the Fifteenth Finance Commission (FFC). Since the tax devolution scheme of the FFC is not yet available in the public domain, we assume that the states' share in central taxes will be 42 percent, as per the recommendation of the Fourteenth Finance Commission. We allocate 42 percent of projected collection of GSTCC to states in this scenario and the rest to the union government (Table 11). We allocate states' share in either Central GSTCC (where GSTCC as Central Tax) or Central part of GSTCC (where GSTCC as concurrent tax) based on share of net proceeds that states are expected to receive on account of Central GST (CGST) as per 2018-19 RE available in the Union Budget 2019-20 (Government of India 2019). If this design is adopted, it will help states to moderate the impact of withdrawal of GST compensation beyond 30 June 2022. This scenario will also leave 58 percent of net proceeds of GSTCC for the union government which could provide additional fiscal space.

In the second scenario, we consider GSTCC as a concurrent tax like GST where both union and state governments will collect GSTCC (at the prevailing rates) concurrently as an additional tax on top of the prevailing tax rates of CGST and SGST respectively from a set of already identified goods those attracting GSTCC. We assume that equality in tax rates between central and state part of GSTCC will prevail and so half of the projected net tax proceeds from the GSTCC has been assigned to states. In addition to states' own collection of GSTCC, a part of central GSTCC will be also shared with states as per the tax devolution formula of the Finance Commission (we assume 42 percent in this exercise). Therefore, states will receive 71 percent (50 percent as own GSTCC and 21 percent of central GSTCC) of net tax collection on account of GSTCC under this scenario. For state-wise collection of state GSTCC, we have distributed aggregate collection of state GSTCC across states based on share in SGST collection (including IGST settlement) observed during Q1:2018-19 to Q3:2018-19, as available from Mukherjee and Rao (2019). This is the first best scenario as far as state finance is concerned. A large part of revenue loss on account of withdrawal of GST compensation will be compensated and state finances will be on relatively comfortable situation. However, in this scenario only 29 percent of net proceeds of the GSTCC will go to the union government.

Table 11 shows that if GSTCC is imposed as central tax from 1 July 2022, states will receive their share in Central GSTCC for Q2-Q4 of 2022-23. Tax devolution would help states to meet on average half of the revenue gap arising due to withdrawal of GST compensation (Table 11). If GSTCC is imposed as concurrent tax from 1 July 2022, both states' share in Central part of GSTCC and state's own GSTCC collection could help states to meet on average two-third to four-fifth of the revenue gap.

Table 11: Assignments of Tax Proceeds of GSTCC between Union and State Governments under Alternative Designs of GSTCC

	2022-23 (Q2 to Q4)	**2022-23 (Q2 to Q4)**	**2022-23 (Q2 to Q4)**	**2022-23 (Q2 to Q4)**
Tax Buoyancy	1.00	0.90		
Estimated GSTCC Collection (Rs. Crore)	1,16,841	1,15,599		
Scenario	**GSTCC as Central Tax**		**GSTCC as Concurrent Tax**	
Tax Buoyancy	1.00	0.90	1.00	0.90
a) Central Share (Rs. Crore)	67,768	67,047	33,884	33,524
b) States' Share (Rs. Crore)	49,073	48,551	24,537	24,276
c) States' Own Tax (Rs. Crore)			58,421	57,799
d) Total (a+b+c) (Rs. Crore)	1,16,841	1,15,599	1,16,841	1,15,599
e) Total GSTCC for States (b+c) **(Rs. Crore)**	**49,073**	**48,551**	**82,957**	**82,075**

f) Total GST Compensation Requirement (Rs. Crore)* – GSTN	1,00,700	1,07,533	1,00,700	1,07,533
g) Total GST Compensation Requirement (Rs. Crore)* – DoR	1,16,943	1,23,603	1,16,943	1,23,603
g) e as % of f	48.73	45.15	82.38	76.33
h) e as % of g	41.96	39.28	70.94	66.40

Note: *- corresponding to Q2 to Q4 of 2022-23
Source: Estimated

A large number of states will benefit from scenario 2 (where GSTCC is a concurrent tax) as compared to scenario 1 (GSTCC as central tax). Even if the scenario 2 is adopted, some states will face fiscal stress in 2022-23 and therefore they need to prepare for the forthcoming fiscal shock. Given the past experience of fiscal shock during 2008-10, states may consider exercising front loading (additional resource mobilization from all possible sources of revenue) and/ or back loading (containing unproductive expenditures) (Mukherjee 2019c). However, containing public expenditure may also impact prospect of future economic growth and therefore revenue mobilization. Adoption of expenditure management to reduce wasteful expenditures could help to achieve fiscal sustainability.

Table 12 shows that depending on design of GSTCC, share in tax devolution in Central taxes and share in overall GST collection, fiscal stress – as measured by the difference between GST compensation requirement and expected revenue from alternative designs of GSTCC – of states will have differential impacts on state finances. Among major states, Andhra Pradesh, Telangana, Uttar Pradesh and West Bengal (except if tax buoyancy is 1 or more) would benefit the most irrespective of design of GSTCC- either as central tax or concurrent tax. Bihar would benefit the most if GSTCC is designed as Central tax whereas Maharashtra, Rajasthan and Tamil Nadu would benefit the most if GSTCC is imposed as concurrent tax. However, the list of most beneficial states may change depending on any change in state's share in tax devolution for the period 2020-25 followed by recommendations of the Fifteenth Finance Commission. Most of the minor states will benefit irrespective of design of GSTCC.

Table 12: State-wise Revenue Gap between GST Compensation Requirement and Revenue Accrued to State from Alternative Designs of GSTCC (as Percentage of Revenue Accrued to State from Alternative Designs of GSTCC)*

Data Source	**GSTCC as Central Tax**		**GSTCC as Concurrent Tax**	
Tax Buoyancy	**1.00**	**0.90**	**1.00**	**0.90**
Major States				
Andhra Pradesh	-93.9	-80.7	-96.2	-87.9
Bihar	-6.6	-1.3	7.9	14.1
Chhattisgarh	123.4	133.3	99.3	108.1
Goa	442.8	466.5	171.7	183.5
Gujarat	428.7	467.1	62.9	74.8

Haryana	771.0	828.7	91.3	104.0
Jharkhand	23.1	31.5	12.7	20.4
Karnataka	504.7	536.3	133.0	145.1
Kerala	262.4	290.1	45.5	56.6
Madhya Pradesh	21.2	29.6	11.2	18.9
Maharashtra	165.0	210.0	-34.3	-23.1
Odisha	135.1	144.9	112.2	121.1
Punjab	1,169.0	1206.8	404.2	419.2
Rajasthan	7.1	20.0	-27.6	-18.9
Tamil Nadu	49.7	80.2	-48.6	-38.2
Telangana	-81.0	-53.9	-93.1	-83.3
Uttar Pradesh	-44.7	-37.1	-49.3	-42.3
West Bengal	-4.4	6.9	-29.7	-21.4
Minor States				
Arunachal Pradesh	-100.0	-100.0	-100.0	-100.0
Assam	-52.9	-45.5	-56.4	-49.5
Himachal Pradesh	594.5	615.5	326.2	339.0
Jammu & Kashmir	172.4	183.0	139.0	148.2
Manipur	-100.0	-100.0	-100.0	-100.0
Meghalaya	-39.2	-35.1	-22.6	-17.4
Mizoram	-100.0	-100.0	-100.0	-100.0
Nagaland	-100.0	-100.0	-100.0	-100.0
Sikkim	-100.0	-100.0	-100.0	-100.0
Tripura	-6.2	-1.1	11.9	17.9
Uttarakhand	522.5	541.8	298.2	310.6

Note: Data Source for GST Compensation Requirement is GSTN

Source: Estimated

6. Conclusions

If the GST compensation is withdrawn after 30 June 2022, consolidated revenue gap of states would vary between Rs. 100,700 crore to 123,646 crore depending on expected tax buoyancy and reliability of data sources. This implies that states will need to either generate an equivalent amount of revenue from exiting sources to continue with committed expenditures and/or cut down expenditures to cope up with revenue shock in 2022-23.

We found that on average major states have to mobilize additional 11-14 percent of the projected SGST collection in 2022-23 to compensate revenue loss on account of withdrawal of GST compensation payment beyond 30 June 2022. The withdrawal of GST compensation and fall in overall SGST collection will have substantial impact on state finances of Punjab, Odisha, Goa, Chhattisgarh and Karnataka among major states. Among minor states, substantial revenue gap is expected for Himachal Pradesh, Uttarakhand, Tripura and Meghalaya.

The impact of withdrawal of GST compensation (post GST compensation period) on state finances will differ across states and states having higher importance on the GST basket of revenue will face the maximum shock. To sustain fiscal consolidation path, states need to augment revenue mobilization from all possible sources of own revenue (tax and non-tax) and/or contain unproductive expenditures. Achieving balance between growths in total revenue receipts and expenditures will be vital to contain revenue as well as fiscal deficits. Possibility of providing additional tax handles to state governments (e.g., taxation power to levy tax on non-agricultural income) may be explored to facilitate states to cope up with any possible fiscal imbalance arising due to differences in taxation power and expenditure responsibilities (Rangarajan 2019).

Many states have approached the Fifteenth Finance Commission (FFC) for possible extension of GST compensation by another three years, i.e., up to 2024-25. The fate of GST compensation period beyond the transition period is not clear yet. Even if the compensation period is extended beyond 30 June 2022, the union government may not have adequate fiscal space to continue with present rate (14%) of compensation to states. Therefore, to reduce arbitrariness in setting growth rate of revenue protection and associated uncertainty associated with achieving the desired growth rate in GST collection, it would be important to explore alternative designs of GSTCC.

If GSTCC continues as an additional cess, like other cesses of the union government post GST compensation period, there will be no share receivable by the states from net proceeds of the GSTCC. So, there will be no improvement of fiscal situation of state finances if GSTCC continues as central cess. If GSTCC is imposed as central tax from 1 July 2022, states will receive their share in Central GSTCC. Tax devolution may help states to meet on average half of the revenue gap arising due to withdrawal of GST compensation post the transition period. If GSTCC is imposed as concurrent tax from 1 July 2022, both states' share in Central part of GSTCC and state's own GSTCC collection could help states to meet on average two-third to four-fifth of the revenue gap

This paper shows that the list of most beneficiary states changes with change in design of GSTCC and therefore accepting any design of GSTCC, post GST transition period, requires emergence of consensus among states. In the absence of any GST compensation, there will be no centripetal (or binding) force for states to continue with the harmonized design and structure of GST. Moreover, in the absence of GST compensation, GST Council may not have freedom to experiment with design, structural and administrative aspects of GST to accelerate stabilization of the GST system. Therefore designing a suitable framework for GSTCC and achieving stability in GST design, structure, compliance and administrative provisions may be the priority of the GST Council.

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