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SLOW CLIMB

	GST revenue for states (₹ trilion)	Share of IGST settlement (%)
2018-19	5.15	45.9
2019-20	5.04	38.7
2020-21	8.05	27.0
2021-22	6.06	48.7
2022-23	7.32	49.0
2023-24	8.35	48.1

Assessing state integration under GST

Despite expectations, state-level integration under GST shows only modest gains in the post-Covid period

The issue of inter-state variations in revenue performance is often a matter of debate. The change in the tax regime from the earlier value-added tax (VAT) to the goods and services tax (GST) marked a transition from a source-based tax to a destination-based tax for states. In the previous regime, inter-state transactions were taxed by the exporting state, whereas now, the revenues accrue to the destination state. This change in the design of the tax regime was argued to shift the revenue to consuming states from producing states. Further, with the introduction of GST, states are expected to become more integrated, with larger volumes of inter-state trade.

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To understand the impact of GST on this aspect of economic activity, we can explore the changes in the share of Integrated GST (IGST) settlements in the total revenue collection of states. IGST is the tax levied on inter-state transactions — the tax is collected by the Union government, with full input tax credit made available to the exporting state. This would mean that the exporting state does not get any revenue from this transaction. On the other hand, in the importing state, the importer can claim input tax credit against local sales, thus transferring the revenue to the importing state. The settlement of claims from IGST for individual states is sorted out through the IGST settlement mechanism. In effect, therefore, IGST settlement can be visualised as the tax on goods and services imported from other states, or even from the rest of the world.

The GST council provides data on the revenues — Central GST, State GST (SGST), and IGST — collected by each state, as well as the amount credited to states via the IGST settlement. Broadly, the revenue accruing to each state would be the sum of SGST — the revenue collected in the state — and the IGST settlement, which is the revenue accruing from imported goods and services. The ratio of IGST settlement to total revenue collection (SGST + IGST settlement) should be a reflection of the "dependence" on inter-state trade or alternatively, the extent of integration with the rest of the country.

Taking all states together, this ratio decreased initially from 45.9 per cent to a low of 27 per cent before recovering to over 48 per cent. In the three post-Covid years, the ratio has remained somewhat stable. Given that market structures evolve over time, this limited evidence for all states combined would suggest a modest increase in integration (*See chart*).

The story can, however, vary across states. Two kinds of differences can be observed — first, the extent of integration, as measured by the ratio of IGST settlement to total revenues differs considerably across states. For 2018-19, this ratio ranged from 20.4 per cent for Uttarakhand to 79.4 per cent for Nagaland. For 2019-20, the range was 20.3 per cent to 70 per cent for the same states. In 2023-24, there is further change — the lowest ratio is now for Jharkhand at 29.2 per cent and the highest is for Mizoram at 72 per cent.

Second, the change in integration has been different across states. Nineteen states show improvement in integration while the rest provide evidence of a decline in the ratio. For some states, integration has progressed rapidly, reflected in a sharp increase in the ratio — states with more than a 5 percentage point increase in the ratio are Uttarakhand, Haryana, Delhi, Punjab, Rajasthan and Gujarat. On the other hand, states which experienced a sharp decline of similar magnitude are Nagaland, Jharkhand, Odisha and Kerala. These diverse trends are worth noting. While a reduction in the ratio for Nagaland can be expected, given that it started off with a very high ratio, the declining ratio for the other three states could indicate an improvement in the nature and scale of economic activity in these states — a change that needs to be explored further.

Apart from the variation in patterns across states, a significant feature to note is the unusual grouping of states. Looking at the data for 2023-24, Maharashtra, Gujarat and Tamil Nadu have a ratio of 40 per cent or less. Maharashtra has a ratio of 34.2, Gujarat has 37.7, and Tamil Nadu has 40.1. As these are states with a diversified industrial sector and a significant services base, it can be argued that they might have more robust local economies. Haryana follows closely behind with 44.4 per cent. In this group of states, we also find Chhattisgarh, Jharkhand, Odisha and Uttarakhand — their ratios are at 41.6 per cent, 29.3 per cent, 35.6 per cent, and 36.6 per cent, respectively.

This latter set of states have a low per capita gross state domestic product (GSDP), low monthly per capita consumption expenditure (MPCE) (from National Sample Survey), and relatively high consumption of cereals. However, these are not the only states that share these features. Another feature common to these states is that they are resource-rich or mineral-rich. Limitations on input tax credit for some minerals — especially those used for power generation — could provide disproportionate local revenues. But once again these states are not the only ones. Are these states undergoing some structural transformations? This puzzle needs to be explored some more.

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