



LEVERAGING DIGITAL GOVERNANCE FOR INCLUSIVE ECONOMIC GROWTH: GST REFORMS AND FISCAL FEDERALISM IN TAMIL NADU

Editors

Dr. A. Anandhiprabha

Dr. M. Jeeva

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Dr. S. Mahalakshmi

Volume - I



A One Day National Seminar on

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Volume I

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Dr. M. Jeeva
Ms. A. Gomathi
Dr. S. Mahalakshmi

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IMPACT OF GST ON MSMES, START-UPS, AND INFORMAL SECTOR FORMALIZATION: LEVERAGING DIGITAL GOVERNANCE FOR INCLUSIVE ECONOMIC GROWTH IN TAMIL NADU



Dr. S.Poongodi

Assistant Professor, PG Department of Commerce-CA
NGM College, Pollachi, Tamil Nadu, India
poongodimuruganantham@gmail.com

Abstract

The introduction of the Goods and Services Tax (GST) in July 2017 represents one of the most significant fiscal and digital governance reforms in India's post-independence history. Conceived as a destination-based, value-added tax system, GST subsumed multiple central and state indirect taxes into a unified framework supported by technology-driven compliance architecture. While GST aimed to enhance transparency, reduce cascading taxation, and create a common national market, its deeper impact lies in reshaping enterprise behavior, especially among Micro, Small and Medium Enterprises (MSMEs), start-ups, and the informal sector. This paper examines how GST has influenced business formalization, digital integration, and compliance dynamics in Tamil Nadu, a state with a robust MSME ecosystem and strong industrial base. It argues that GST has accelerated formalization and digital adoption, yet imposed transitional compliance burdens that require adaptive policy responses within India's cooperative fiscal federal framework.

Keywords: GST- MSMEs- Informal Sector- Start-Ups- Digital Governance

Introduction

The enactment of GST followed the passage of the Constitution (One Hundred and First Amendment) Act, 2016, which restructured India's indirect tax regime and recalibrated Centre-State fiscal relations. GST replaced a fragmented system of excise duty, service tax, value-added tax, entry tax, and other levies with a harmonized structure administered jointly by the Union and the States. Beyond fiscal consolidation, GST embodies a digital governance reform anchored in real-time data flows, invoice matching, and online compliance systems. Tamil Nadu provides an important case study for examining GST's broader economic implications. As one of India's most industrialized states, with established clusters in textiles, automobiles, leather, electronics, and information technology, Tamil Nadu hosts a dense concentration of MSMEs and emerging start-ups. The state's relatively advanced digital infrastructure and administrative capacity make it well positioned to leverage GST reforms. At the same time, the large presence of informal and micro enterprises reveals the uneven effects of digital tax modernization.

GST as Digital Governance Infrastructure

GST operates through the technological backbone provided by the Goods and Services Tax Network (GSTN), which facilitates online registration, return filing, input tax credit reconciliation, and compliance monitoring. This platform-based administration marks a transition from manual, paper-based tax systems to algorithm-driven governance. Every transaction within the GST framework generates a digital footprint, enabling cross-verification and reducing the scope for discretionary enforcement. For enterprises integrated into formal supply chains, the digital infrastructure enhances transparency and efficiency. However, for smaller businesses unfamiliar with digital systems, the shift requires adaptation in accounting practices, documentation standards, and financial planning. The move toward data-driven compliance has therefore redefined the relationship between the state and enterprises, making digital literacy and technological access central to economic participation.

Impact on MSMEs in Tamil Nadu

MSMEs constitute the backbone of Tamil Nadu’s industrial economy, contributing significantly to employment generation and export performance. Under the pre-GST regime, these enterprises navigated multiple indirect taxes, often facing cascading tax effects and logistical barriers at interstate checkpoints. GST removed many of these distortions, reducing transportation delays and integrating state markets into a unified national market. For export-oriented textile and auto-component clusters in Coimbatore, Tiruppur, and Chennai, the elimination of check posts and harmonization of tax rates improved supply chain efficiency. At the same time, GST introduced new compliance requirements. Frequent return filings, invoice reconciliation, and adherence to evolving procedural norms increased administrative responsibilities. Smaller MSMEs, lacking dedicated tax departments, often rely on external accountants, thereby raising operational costs. Working capital pressures arising from delays in input tax credit refunds have been particularly acute for export-oriented firms. Despite these challenges, GST has incentivized MSMEs to adopt formal accounting systems, digitize transactions, and strengthen documentation practices, thereby improving creditworthiness and access to institutional finance.

Impact on Start-ups and Digital Enterprises

For start-ups, especially those operating in technology-driven sectors, GST has produced relatively positive outcomes. The removal of interstate tax barriers has facilitated seamless expansion across state boundaries, allowing start-ups to scale operations without navigating differential tax regimes. In Tamil Nadu’s growing technology corridors, particularly in Chennai and Coimbatore, digital enterprises benefit from standardized taxation of services and improved clarity in cross-border transactions. Moreover, GST’s digital compliance framework aligns with the operational models of start-ups accustomed to cloud-based systems and online platforms. The availability of standardized transaction data has also enhanced the capacity of fintech firms to assess credit risk and develop invoice-based financing solutions. Nevertheless, early-stage start-ups with limited turnover sometimes

experience compliance strain, particularly when adapting to e-invoicing thresholds and reconciliation requirements. Overall, GST has strengthened the digital ecosystem in which start-ups operate, reinforcing integration into formal financial and regulatory systems.

Informal Sector Formalization

One of GST’s most significant structural impacts has been its role in encouraging formalization. The input tax credit mechanism creates incentives for businesses to transact with registered suppliers, thereby drawing previously informal enterprises into the tax net. Invoice matching and e-way bill requirements increase transparency across supply chains, reducing the viability of cash-based informal transactions. In Tamil Nadu’s manufacturing clusters, many small suppliers sought GST registration to maintain relationships with larger firms. This supply-chain-driven formalization has expanded the tax base and improved documentation of economic activity. Formalization enhances eligibility for institutional credit, government schemes, and export incentives, potentially increasing productivity and competitiveness. However, the transition from informality to formal compliance entails adjustment costs, including digital literacy acquisition and financial discipline. Some micro enterprises choose to remain below threshold limits, indicating that formalization is gradual and contingent on perceived net benefits.

Fiscal Federalism and State Capacity

GST represents a landmark experiment in cooperative fiscal federalism, governed through the GST Council, where the Union and States jointly determine rates and procedural norms. For Tamil Nadu, a manufacturing-intensive state, initial apprehensions regarding revenue implications under destination-based taxation were significant. Over time, compensation mechanisms and stabilization of compliance have mitigated many of these concerns. The effectiveness of GST implementation depends substantially on state-level administrative capacity. Tamil Nadu’s relatively advanced digital governance infrastructure, established industrial networks, and proactive tax administration have facilitated smoother adaptation. The state’s engagement in taxpayer education, outreach programs, and digital facilitation centers demonstrates how subnational governments play a crucial role in translating national reforms into inclusive growth outcomes.

Challenges and Policy Implications

While GST has promoted transparency and market integration, challenges persist. Compliance complexity, technological adaptation costs, and periodic regulatory changes create uncertainty for smaller enterprises. Ensuring timely refund processing and simplifying return procedures remain critical for sustaining MSME competitiveness. Digital literacy initiatives, localized support services, and stable policy communication can reduce transitional stress. Inclusive growth under GST requires balancing revenue integrity with administrative simplicity. Strengthening technological interoperability, enhancing grievance redressal systems, and ensuring linguistic accessibility on digital portals can further integrate smaller businesses into the formal economy. Tamil Nadu’s experience

suggests that coupling digital governance with institutional support mechanisms enhances reform outcomes.

Conclusion

The introduction of GST has reshaped India’s economic governance landscape by combining fiscal unification with digital administration. In Tamil Nadu, the reform has had multifaceted impacts on MSMEs, start-ups, and the informal sector. For MSMEs, GST has reduced structural inefficiencies and improved supply chain integration, albeit at the cost of higher short-term compliance demands. For start-ups, it has enabled national scalability and alignment with digital business models. For the informal sector, it has created incentives for gradual formalization and integration into formal financial networks. Ultimately, the GST experience underscores that digital governance reforms can advance inclusive economic growth when supported by strong institutional capacity and cooperative federalism. Tamil Nadu’s trajectory illustrates how state-level readiness, industrial dynamism, and adaptive policy responses determine whether fiscal modernization translates into broad-based economic empowerment.

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