



Review Paper

## Equity vs Efficiency in GST: A Textile Sector Perspective

Vijayalaxmi Baddi<sup>1\*</sup> and Gurupad Junnaykar<sup>2</sup>

<sup>1</sup>Government First Grade College, Yaragatti, Rani Channamma University, Belagavi, Karnataka, India

<sup>2</sup>S.T.C Arts and Commerce College, Banahatti, Karnataka, India  
vijayalaxmi1504@gmail.com

Available online at: [www.isca.in](http://www.isca.in), [www.isca.me](http://www.isca.me)

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### Abstract

*The implementation of the Goods and Services Tax (GST) in India represents a major fiscal reform aimed at enhancing economic efficiency through tax uniformity and the elimination of cascading effects. However, the reform has also raised concerns regarding equity, particularly in sectors characterized by structural dualism such as textiles. This paper examines the trade-off between equity and efficiency in the GST framework with specific reference to the textile sector. Using a conceptual and analytical approach based on secondary data, the study finds that while GST has significantly improved efficiency through supply chain integration, cost reduction, and formalization, it has simultaneously created disparities by imposing compliance burdens and excluding unorganized rural producers from key benefits such as input tax credit. The paper concludes that GST, in its current form, prioritizes efficiency over equity and suggests policy interventions to achieve a more balanced and inclusive tax regime.*

**Keywords:** GST, Equity, Efficiency, Textile Sector, Input Tax Credit, Unorganized Sector, Tax Reform.

### Introduction

Taxation plays a critical role in shaping economic development by influencing resource allocation, income distribution, and market efficiency. The introduction of GST in India in 2017 aimed to streamline the indirect tax system under the principle of *One Nation, One Tax*. By subsuming multiple taxes into a unified structure, GST sought to enhance efficiency and transparency. As per *The Central Goods and Services Tax Act, 2017*, Ministry of Law and Justice, this reform aimed to improve efficiency, transparency, and ease of doing business. The textile sector, however, is highly fragmented, consisting of both organized firms and unorganized rural producers.

The textile sector, one of the largest contributors to employment and GDP in India, presents a unique case due to its **dual structure**, a well-organized industrial segment coexisting with a vast unorganized rural base. This dualism raises important questions regarding the distributional impact of GST.

This paper explores whether GST has achieved a balance between **equity (fair distribution of tax burden)** and **efficiency (optimal resource allocation)** in the textile sector.

**Literature review:** Recent studies on GST and the textile sector highlight a mix of efficiency gains and equity concerns. The Ministry of Textiles Annual Report 2024-25<sup>1</sup> emphasizes the sector's significant contribution to employment and exports while noting the role of GST in policy reforms. Subsequent studies by Government of India<sup>2</sup> show that GST rationalization

has improved affordability, reduced production costs, and enhanced competitiveness in the textile market.

Kesarwani<sup>3</sup> conducted research on manufacturing and pricing indicates that GST has streamlined taxation and improved cost efficiency for large firms, although smaller firms continue to face compliance-related challenges. Similarly, Reddy, K. S., & Kumar, P<sup>4</sup> studies on rural textile industries reveal that while GST has increased transparency and formalization, it has disproportionately burdened small and unorganized producers due to limited access to input tax credit.

Sustainability-focused research done by Sharma & Mehta<sup>5</sup> further highlights that GST-related compliance creates barriers for MSMEs, suggesting the need for integrated policy support.

More recent analyses by Patel D & Singh R<sup>6</sup> in 2026 show that GST rate reductions have boosted demand, profitability, and export potential, especially for MSMEs, though digital compliance remains a persistent issue. Studies on cost structure and pricing confirm that GST has significantly altered production costs and improved efficiency, but the benefits are uneven across different segments of the industry.

Additionally, research on price transmission by Rao, M. G., & Kumar, S<sup>7</sup> finds that GST rate cuts are not fully passed on to consumers, indicating market inefficiencies and incomplete realization of welfare benefits. Overall, the literature suggests that while GST has enhanced efficiency in the textile sector, concerns regarding equity, particularly for small and unorganized producers, remain inadequately addressed. Most studies highlight efficiency gains, but limited research focuses on balancing equity and efficiency in the textile sector.

**Objectives of the study:** i. To analyse the concepts of equity and efficiency in taxation, ii. To evaluate GST's impact on efficiency in the textile sector, iii. To assess equity implications for organized and unorganized segments, iv. To examine the trade-off between equity and efficiency, v. To suggest policy measures for inclusive tax reform.

## Methodology

This study is conceptual and analytical in nature and is based on i. Secondary data from government reports, journals, and policy papers, ii. Theoretical frameworks from public finance and welfare economics and iii. Comparative analysis of pre-GST and post-GST scenarios.

Since no primary data has been collected, the research focuses on theoretical analysis and policy evaluation rather than empirical measurement. This approach is suitable for understanding broad structural impacts and developing conceptual arguments.

**Theoretical framework: Equity in Taxation:** Equity in taxation refers to fairness in how the tax burden is distributed among individuals and businesses. It includes horizontal equity, where individuals with similar economic capacity are taxed equally, and vertical equity, where those with higher ability to pay contribute more. Hence, horizontal equity ensures equal treatment of equals, while vertical equity considers differences in income levels<sup>8</sup>. In the textile sector, equity becomes a concern because large textile firms and small handloom weavers operate under very different conditions. While large firms can comply with GST requirements easily, small rural producers often struggle, leading to unequal treatment and outcomes.

**Efficiency in Taxation:** Efficiency in taxation refers to the ability of a tax system to minimize distortions in economic activities. An efficient tax system ensures that production, consumption, and investment decisions are not negatively affected. GST promotes efficiency by eliminating cascading taxes, enabling input tax credit, and creating a unified national market. These features reduce production costs, improve supply chain management, and enhance overall productivity in the textile sector<sup>9,10</sup>.

**Equity-Efficiency Trade-off:** The trade-off between equity and efficiency is a central concept in welfare economics, reflecting the tension between fair distribution and optimal resource allocation. As explained by Joseph E. Stiglitz<sup>11</sup>, policies that maximize efficiency often result in unequal distribution of benefits, while those aimed at achieving equity may reduce overall economic efficiency. In the context of GST, the reform was primarily designed to enhance efficiency by simplifying the tax system and creating a unified national market. The introduction of Input Tax Credit (ITC) and removal of cascading taxes have improved cost efficiency and productivity in the textile sector.

However, these efficiency-driven measures have not equally benefited all participants. Small and unorganized textile producers often lack the capacity to comply with GST requirements, leading to their exclusion from key benefits. This results in higher production costs and reduced competitiveness for these groups. Consequently, the gains from GST are concentrated among organized firms, widening the gap between formal and informal sectors. The compliance burden and digital requirements further intensify this inequality. Thus, GST illustrates a classic equity-efficiency trade-off, where improvements in efficiency are achieved at the cost of equity.

## Results and Discussion

**GST and Efficiency in Textile Sector:** GST has significantly improved efficiency in the textile sector by eliminating the cascading effect of taxes. Previously, multiple taxes were imposed at different stages of production, increasing the overall cost. GST allows businesses to claim input tax credit, which reduces this burden and lowers production cost i.e., enhancing cost efficiency<sup>12</sup>. Additionally, the removal of interstate barriers has improved supply chain efficiency, enabling faster movement of goods across states. GST has also encouraged formalization, as businesses are required to register and comply with tax regulations. This has expanded the tax base and improved transparency<sup>13</sup>. Furthermore, organized textile firms have gained a competitive advantage due to better cost management and increased access to national and international markets<sup>14</sup>.

**GST and Equity in Textile Sector:** Despite efficiency gains, GST raises equity concerns. Many small and unorganized textile producers are unable to register under GST, preventing them from claiming input tax credit and increasing their cost burden<sup>15</sup>. Compliance requirements such as digital filing and documentation pose challenges for rural artisans. The multi-rate GST structure also creates inconsistencies in taxation. These factors have negatively affected traditional handloom sectors and rural livelihoods, highlighting issues of social and economic inequality<sup>16</sup>.

**Comparative Analysis: Organized vs Unorganized Sector:** GST has created a clear divide between organized and unorganized sectors. Organized firms benefit from input tax credit, better compliance systems, and expanded market access, resulting in lower costs and higher profitability. In contrast, unorganized sector participants face higher costs, difficulties in registration and compliance, limited access to benefits, and reduced competitiveness. While organized firms expand their market reach, small producers struggle to sustain their operations. This disparity demonstrates the unequal distribution of GST benefits<sup>17</sup>.

**Equity vs Efficiency:** The analysis of GST in the textile sector clearly indicates that the reform has been highly effective in enhancing economic efficiency. By replacing a complex system of multiple indirect taxes with a unified structure, GST has

simplified taxation and reduced administrative barriers. The introduction of Input Tax Credit (ITC) has eliminated the cascading effect of taxes, thereby lowering production costs and improving price competitiveness. In addition, the removal of interstate checkpoints and tax variations has streamlined supply chain operations, enabling faster movement of goods and reducing logistics costs. These changes have particularly benefited the organized textile sector, which has the capacity to comply with GST requirements and fully utilize its advantages.

However, these efficiency gains have not been equitably distributed across all segments of the textile industry. A significant portion of the sector operates in the unorganized and informal domain, consisting of small-scale weavers, artisans, and rural producers. These groups often lack the resources, digital literacy, and institutional support required to comply with GST regulations. As a result, many remain outside the formal tax system and are unable to claim ITC, leading to higher effective costs of production compared to organized firms. This creates a competitive imbalance, where large firms gain disproportionately while small producers struggle to sustain their livelihoods.

Moreover, the compliance burden associated with GST, such as online return filing, invoice matching, and documentation, places additional pressure on small and medium enterprises. For many rural textile units, these requirements are not only complex but also costly, leading to partial or complete exclusion from the system. This exclusion undermines the principle of horizontal equity, as similar producers are treated differently based on their ability to comply. It also raises concerns regarding vertical equity, as economically weaker participants bear a relatively higher burden.

As noted by M. Govinda Rao<sup>18</sup>, while GST represents a major step toward improving tax efficiency and creating a unified market, it also exposes structural inequalities within the economy. The reform tends to favour sectors and firms that are already formalized and technologically equipped, thereby widening the gap between organized and unorganized segments. In a labour-intensive sector like textiles, this has important implications for employment, income distribution, and social welfare.

Therefore, the overall evidence suggests that GST, in its current design, prioritizes efficiency over equity. While it has succeeded in achieving macroeconomic objectives such as cost reduction, transparency, and market integration, it has simultaneously created challenges related to inclusiveness and fairness. This imbalance raises important policy concerns, particularly in ensuring that the benefits of economic reforms are broad-based and socially inclusive. Addressing these issues requires targeted interventions, such as simplifying compliance procedures, extending support to small producers, and designing policies that bridge the gap between efficiency and equity.

**Policy implications and recommendations:** To address the imbalance between equity and efficiency, several policy measures are necessary. Simplifying GST compliance procedures can help small businesses participate more effectively in the tax system. Extending input tax credit benefits or providing alternative support mechanisms for unregistered units can reduce cost disparities. Rationalizing tax rates can improve fairness and reduce complexity. Additionally, providing subsidies and financial support to the handloom sector can protect traditional industries. Digital literacy programs are essential to help rural entrepreneurs adapt to GST requirements. Strengthening cooperative structures can also improve market access and bargaining power for small producers<sup>19</sup>.

Equity vs Efficiency in GST: A Textile Sector Perspective

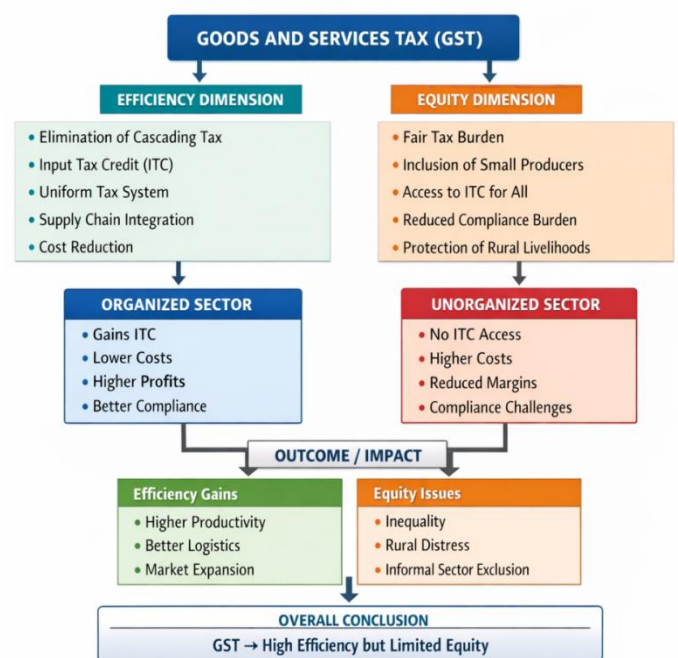


Figure-1: Conceptual Framework.

## Conclusion

GST has significantly improved efficiency in India's textile sector by creating a unified tax system and enhancing supply chain integration. However, it has also created inequalities, particularly affecting small and unorganized producers. The study concludes that GST prioritizes efficiency over equity and emphasizes the need for policy interventions to achieve a balanced and inclusive tax system.

**Scope for future research:** Future research can build on this study by incorporating empirical data collected from textile clusters to validate the conceptual findings. Comparative studies across different states can provide deeper insights into regional variations. Researchers can also explore the impact of GST on textile exports and global competitiveness.

Additionally, gender-based studies can examine how GST affects women workers in the handloom sector. These areas offer opportunities for further exploration and policy development.

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