

General Studies-2; Topic: Functions and responsibilities of the Union and the States, issues and challenges pertaining to the federal structure

GST Compensation to States

Introduction

- The payment of GST compensation has plunged the Union-state relationship to a new low.
- As the economy battles a pandemic and recession, the tax collection has dropped significantly, while expenditure needs are sharply higher.

Background

- In 2017, the Centre made a promise to the States that a certain minimum amount of GST revenues will be guaranteed to every State for every year until 2022.
- This reimbursement was to be funded by a special cess called the GST compensation cess.
- Creation of the GST Council in 2017 was hailed as a great example of cooperative federalism.
- The states had agreed to join in the reform even as it involved sacrificing their fiscal autonomy.
- There was a clear commitment of the Centre on the issue of compensation and the method of recouping the loss.
- Now, there is not enough money for the Centre to honour this obligation

Present Status

- The Centre had estimated the states' total loss of GST revenue at Rs 3 lakh crore, of which, Rs 65,000 crore was expected to accrue from the compensation cess.
- Of the remaining Rs 2.35 lakh crore, the loss due to an "Act of God" — the pandemic — was estimated at Rs 1.28 lakh crore.
- In the recent GST Council meet, the Union government had presented the states with two options.
- The first option was to provide states a special window to borrow Rs 97,000 crore from the RBI, which was later revised to Rs 1.1 lakh crore.
- Under this option, both the interest payments and the repayments would be made from future collections of the compensation cess.
- In the second option, the entire shortfall of Rs 2.35 lakh crore could be borrowed from the market and the states would have to bear the interest costs, but the repayments would be adjusted against future collections of the cess.
- While some states have opted for first option, some have rejected both the options and have stated that it is the Centre's responsibility to compensate the states, and therefore, it should borrow.

Arguments against Centre's Decision

- The presentation of the two options without any discussion in the council and mandating the states to choose one of the options was not in the spirit in which the compensation was promised.
- By not recognising the Centre's commitment, it will make states wary of any future reforms involving an agreement with the Centre.

Arguments in the favour of Centre borrowing for States

- For the future of Centre-state relations, Centre should borrow to fund states' GST loss.
- It is the Centre's commitment to find the compensation mechanism and borrowing is one of the options — that must be discussed in the Council.
- As the **interest rate of the Centre's borrowing is lower than that of the states**, the Centre should take the responsibility to borrow.
- Both the interest and principal payment can be met from future collections from the cess.

- This is not merely a matter related to compensation, but has to do with the **credibility of honouring the agreement**.
- Pressuring states on the basis of political strength will have adverse consequences for the **country's federal structure**.
- State governments don't have the powers to levy direct taxes or indirect taxes to earn additional revenues.
- Centre can issue sovereign bond (in dollars or rupees) or a loan against public sector unit shares from the Reserve Bank of India.
- **Fiscal stimulus is basically the job of macroeconomic stabilisation, which is the Centre's domain.**

Other Revenue Alternatives for Centre

- **Increasing the taxation of capital market transactions.** Between April and June, India's stock markets experienced its highest activity levels in its history.
- The Centre can levy a higher tax on such speculative stock market trading to earn additional revenues.
- Such options for new revenue generation are not available for the States.

Way Forward

- A combination of additional revenues and borrowing by the Centre can help resolve the GST compensation issue amicably.
- The Centre could borrow on behalf of the cess fund. The tenure of the cess could be extended beyond five years until the cess collected is sufficient to pay off this debt and interest on it.
- The GST Council, which is a constitutional body with representation of the Centre and all the States, should find a practical solution.