

IN 'ACT OF GOD', COERCIVE NOT COOPERATIVE FEDERALISM

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Public Finance, Taxation & Black Money incl. Government Budgeting

It is beyond anyone's imagination that the Government of India would invoke the "[Force Majeure](#)" clause against its own people. Unfortunately, this has become reality at a time when every Indian State is massively burdened by the [COVID-19 crisis](#) and governance has been severely affected.

Finance Minister Nirmala Sitharaman's statement on Thursday that the financial crisis facing the States is a [result of an "act of God"](#) is symptomatic of the callousness with which the Narendra Modi government treats State governments. This abdication of responsibility strikes a cruel blow to the social contract that exists between the Government of India and State governments, who are equal representatives of the 1.3 billion citizens of India.

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The Goods and Services Tax (GST) regime was built on the promise that if States faced revenue deficits after the GST's introduction, the Centre would make good the loss in the first five years. It was on the basis of this commitment that States extended their support to GST. States sacrificed their constitutionally granted powers of taxation in the national interest. That allowed the Centre to announce the dawn of "one nation one tax" at the stroke of midnight in 2017!

When the GST compensation cess exceeded the amount that had to be paid to States, the Central government absorbed the surplus. Now, the economy has slowed down dramatically and the resources raised are insufficient. Instead of exploring other viable options, the Centre is orchestrating a charade and raising questions about whether it is legally accountable to pay compensation. A reading of the Goods and Services Tax (Compensation to States) Act 2017 and the Constitution 101st Amendment answer these questions affirmatively. Alas, the government's objective is to obfuscate.

It is one thing to say that there are no funds available but entirely another to assert that there is no commitment to pay compensation. This commitment has a history that begins with United Progressive Alliance era when many Bharatiya Janata Party-ruled States strongly pitched for a compensation mechanism to be a part of the Constitution itself. Paragraph 92 of the Standing Committee report shows that the Centre assured payment of compensation for a specified period, if there were such a loss.

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When the Narendra Modi government introduced the GST compensation cess, many States pointed out that proceeds from the cess may be inadequate to fund the losses faced by States after the rollout of GST. Allaying these apprehensions, the central government made the assurance that it would provide funds to meet States' deficits. In the seventh meeting of the GST Council, the Chairman (then Finance Minister Arun Jaitley), observed that it was the constitutional commitment of the central government to provide cent per cent compensation.

This was reinforced in the eight meeting of the Council. In the tenth meeting, the Secretary of

the GST Council stated that the central government could raise resources by other means for compensation and this could then be recouped by continuing the cess beyond five years.

Therefore, there was never any ambiguity in the minds of States that succour will be offered by the Centre. The constitutional framework that ushered in the GST does not provide an escape clause for 'Acts of God'. States never expected to be disappointed so early. The central government has let them down by thrusting on them two options, both of which involve borrowing by States. This is akin to asking States to mortgage their future to sustain the present. Cooperative federalism has been transformed into coercive federalism.

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The central government has the ability to raise resources through means that are not available to States. Monetary measures are the monopoly of the central government. Even borrowing is more efficient and less expensive if it is undertaken by the Central government.

Over the last six years, the Centre has continually cornered resources that should have been shared with States. The Fourteenth Finance Commission allotted 42% of central government tax revenues to States. However, Accountability Initiative's analysis of State Budgets shows that States received only 30% of central tax collections during the 2015-19 period.

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The Centre raised an estimated 3,69,111 crore revenue through cesses and surcharges in 2019-20 alone. These are not shareable with States.

Similarly, cesses on petroleum products have resulted in the Centre receiving 60% of petroleum tax revenues, with only 40% going to States. In 2013-14, the ratio was 50-50.

As equal representatives of the citizens of the federal republic of India, State governments expected the Centre to demonstrate empathy when they are bearing the brunt of the COVID-19 pandemic and lockdowns that were announced without consultation. This is the most appropriate time to provide them relief through the Consolidated Fund of India.

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Prime Minister Narendra Modi proudly described GST as a 'Good and Simple Tax' which would usher in a glorious economic future for India. Unfortunately, just three years later, the harsh reality is that States are staring at 'grave and sordid times' ahead.

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