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STATES CANNOT BE LEFT TO THE CENTRE'S MERCY

Relevant for: Indian Polity | Topic: Issues and Challenges Pertaining to the Federal Structure, Dispute Redressal Mechanisms, and the Centre-State Relations

Karur MP S. Jothimani recently conducted a telephonic survey of 30 lakh people in Tamil Nadu on the re-opening of liquor shops in the State during lockdown 3.0. An overwhelming 89% were opposed to the move.

Also read | Maharashtra allows home delivery of liquor

The Maharashtra government too decided to permit liquor shops to open but was quickly forced to reverse its decision in some parts of the State following protests. Similar protests against the sale of alcohol were seen in various States. This may be largely due to fears of crowding and the consequent spread of COVID-19 rather than about alcoholism and its potentially deleterious societal impact. Whatever may be the reason, it is clear that permitting the sale of alcohol during the lockdown is an unpopular move among the majority. Why then have popularly elected governments in nearly every State resorted to this move? The answer lies in what happened 'at the stroke of midnight hour' on July 1, 2017.

It is apparent that financially broke State governments are forced to adopt desperate and reviled measures such as opening liquor shops to mobilise money for their fight against COVID-19. The question is, even if they are strapped for resources, surely there must be other means to raise funds in this struggle to save lives than to prey on people's alcohol addiction? Therein lies the rub.

All the States have come together like "pearls on a string" in the "spirit of cooperative federalism" for the economic integration of India, said Prime Minister Narendra Modi at the stroke of midnight hour on July 1, 2017 when he launched the Goods and Services Tax (GST). What was not mentioned was that the States on that "pearl string" were now stuck to the Centre's neck forever. GST forced the States to surrender their powers to raise resources independently through local State taxes and place them entirely at the mercy of the Centre for most of their financial needs.

Most States raise resources through a combination of their own taxes and a share in the Centre's taxes. For richer States such as Maharashtra, Tamil Nadu, Gujarat, Delhi, Karnataka, Punjab, Haryana and Kerala, 70% or more of their revenue comes from taxes generated within their State boundaries. Nearly half of these were from the sale of goods and services within the State and the remaining half, from a combination of excise duties on petrol, electricity, alcohol, land registration fees, etc. Before GST, States were free to charge sales taxes as legislated by their State legislatures. If a State had a natural disaster, they could raise additional resources for rehabilitation by raising sales tax rates on goods and services.

For the sake of GST, States sacrificed their fiscal powers in the promise of 'economic efficiency' and 'tax buoyancy', which never materialised. Under GST, States are legally entitled to their share of tax revenues collected in their State. But they are now reliant on the Centre to release these funds to them periodically. When the GST was enacted, States were also guaranteed a minimum tax revenue every year for a period of five years. In the midst of the current pandemic, the Centre has reneged on both these promises.

This is a triple blow for the States — not being paid what they are owed, not being helped with additional resources, and bearing the brunt of the pandemic's impact. Not only are they not paid what is rightfully due to them, they have also lost the powers to raise their own sales tax revenues. So, how are they supposed to fight this health calamity with no money?

The other available options for States to raise funds are through taxes on sale of petroleum products, alcohol, lottery tickets, electricity, land or vehicle registration. During this extreme lockdown, demand for petroleum products, electricity, land and vehicles has dwindled substantially. So, the only option left for most States is to raise funds through the sale of alcohol. For the large, richer States, alcohol sales account for more than one-third of their State tax revenues. One could argue that alcohol consumption could even potentially increase during the lockdown and hence States have been tempted and coerced to resorting to raising monies from people's alcohol habits. Ironically, the States are being forced to rely on alcohol for resolving a health crisis.

Also read | Supreme Court asks States to consider online sale of liquor

Can't the States borrow money to tide over this crisis? In order to do that, they need the Centre's approval to raise their borrowing limit or to stand as guarantors. Since States do not have clear revenue visibility, the rates at which they can borrow are very high and their ability to borrow is severely undermined. They are once again dependent on the Centre to borrow funds from the market and then release them to the States.

How would the States have handled this crisis in the pre-GST era? One, they would have had the funds raised through sales taxes to themselves and not be at the Centre's mercy to release funds. Two, they would have raised taxes on select essential goods sold in their States (say, mangoes or coconut oil) in accordance with their norms. Just as it is clear that COVID-19 has to be fought in a decentralised manner at the local level and not through a Delhi diktat, the resources needed to fight this disease should also be raised locally and not be dependent on Delhi's whimsical magnanimity.

The Centre has defaulted on its financial obligations to the States at a critical juncture. Former Finance Minister Arun Jaitley's catchphrase "cooperative federalism" has proved to be neither cooperative nor federalist in times of this crisis. The idea of 'one nation, one tax' is deeply flawed in an economically and politically divergent India, as I have argued since 2015. Ruling parties and alliances in States can change every five years. The efficient functioning of a GST regime cannot be beholden to political party affiliations at the Centre and the States. Democratically elected State governments cannot be expected to govern with no fiscal powers. Five States account for half of all GST collections in the country. It is time these bigger States challenge the very idea of GST.

Praveen Chakravarty is a political economist and a senior office-bearer of the Congress party

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