

THE FEDERALISM TEST

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

ON THE ISSUE of compensating states for the loss of their GST revenues, in the 41st meeting of the GST Council held on August 27, the Union government had presented the states with two options. 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. 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 the states ruled by the [BJP](#) and its allies have opted to take the first option, 10 states ruled mainly by the Opposition parties have rejected both the options and have stated that it is the Centre's responsibility to compensate the states, and therefore, it should borrow.

Building the consensus which culminated in the creation of the GST Council in 2017 to levy GST — a unified domestic consumption tax — 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. Concerned with their Central Sales Tax compensation experience, states wanted a firm assurance from the Centre. The minutes of the 7th and 8th GST Council meeting show that most of the states wanted the Centre to commit on paying compensation from the Consolidated Fund of India (CFI) at which the Union Finance Minister had stated, "...Compensation to the States shall be paid for 5 years in full within the stipulated period of 5 years and, in case the amount in the GST compensation fund falls short of the compensation payable in any bi-monthly period, the GST Council shall decide the mode of raising additional resources including borrowing from the market which could be repaid by collection of cess in the sixth year or further subsequent years" (Para 23 iii. Page 27 of the minutes of the 8th meeting) Thus, there was a clear commitment of the Centre on the issue of compensation and the method of recouping the loss.

The payment of compensation has plunged the Union-state relationship to a new low. Besides the issue of compensation itself, the way the entire episode has been managed smacks of gaming and strategy in a period of crisis which does not augur well for the future of the Union-state relationship. First, the presentation of the two options without any discussion in the council and mandating that states choose one of the options within a week was not in the spirit in which the compensation was promised. In fact, renegeing on the agreement, by not recognising the Centre's commitment, will make states wary of any future reforms involving an agreement with the Centre. Second, giving selective press statements from time to time by "officials" and "sources" to pressurise the states into accepting one or the other option does not infuse confidence. There was a statement in the press a few days ago that 21 states have accepted the first option and if the rest of the states do not exercise their option within a week, they will have to wait until 2022. Third, there was a statement by the Union finance ministry officials that the GST Council does not have jurisdiction over borrowing and borrowing is an individual state and Centre's decision under Article 293 of the Constitution. If so, why were the two borrowing options presented to the states in the meeting of the Council? Is this not completely contrary to the promise made by the finance minister in the 8th meeting of the council quoted above?

The issue is one of compensation to be paid to the states for which a solution must be found. 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. Furthermore, if the commitment of the Centre is recognised as admitted by the finance minister in the 7th GST council meeting, given the relative fiscal strength of the Centre and the states and 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 interest payments and repayment of the principal liability can be met from future collections from the cess.

This issue is of immense significance for the future of Centre-state relations. This is not merely a matter related to compensation for the loss of revenue, but has to do with the credibility of honouring the agreement. So far deliberations in the council have been carried out in the spirit of camaraderie. But pressuring states on the basis of political strength will have adverse consequences for the country's federal structure.

***The writer was member, Fourteenth Finance Commission and former director, NIPFP.
Views are personal***

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