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GRIM SOVEREIGN TANGLE: THE HINDU EDITORIAL ON GST COMPENSATION STANDOFF

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

Three years after India's new indirect tax regime was introduced with a slogan of 'One Nation, One Tax', it faces an existential crisis. Despite its patchy structure with too many rates, complex compliance requirements and multiple mid-course changes, the implementation of the Goods and Services Tax (GST), overseen together by the Centre and the States, had begun to almost serve as an exemplar of co-operative federalism. All of those gains have quickly unravelled as the slowdown in the economy, exacerbated by the COVID-19 lockdowns, has thrown all revenue calculations to the wind. The Centre is obliged to pay to the States, for a period of five years, compensation for revenue shortfalls in return for their having ceded the power to levy the multiple taxes that were subsumed into the GST. Last week, Finance Minister Nirmala Sitharaman asserted, at what may have been the most tenuous GST Council meeting so far, that the Centre will not be able to meet the compensation shortfall. With GST collections sharply undershooting all targets this year, the Centre estimates compensation payable for the full year at 3-lakh crore. But just 65,000 crore is expected in the cess kitty used to pay out the compensation.

In July, the Centre paid out the last instalment of compensation for the last fiscal and is, so far, yet to pay anything for this year. States have now been given two options, both requiring them to borrow from the market. The Centre contends that only 97,000 crore of the revenue shortfall is from implementation of the GST, while 1.38-lakh crore is due to extraordinary circumstances posed by an 'Act of God' (the pandemic). States can either borrow 97,000 crore, without having it added to their debt and with the principal and interest paid out from future cess collections, or they can borrow the entire 2.35-lakh crore shortfall, but will have to provide for interest payments themselves. The Finance Ministry has argued that higher borrowing by the Centre will push up interest rates and dent India's fiscal parameters. At best, this is specious — total government debt, including States', is what rating agencies look at. Several States have rejected both options and some, including Tamil Nadu, have urged the Centre to rethink in view of their essential and urgent spending needs to curb the pandemic and spur growth. A staring match is in the offing. It is up to the Centre to resolve this impasse in a way that future GST reforms do not fall victim to the trust deficit engendered by this standoff, the pandemic response is strengthened and all-round government capital spending to bolster sagging demand not derailed. For now, the only certainty is that the compensation cess levied on demerit goods will stay on beyond 2022, and may even be raised, affecting several businesses, including the jobs-intensive auto sector.

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