

Gist of EPW September Week 3, 2020

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The Impasse over GST Compensation

Context

- The slowdown in economic activities exacerbated by the outbreak of [Covid-19](#) along with consistent lockdowns has resulted in the severe contraction of the Indian economy.
- It has led to adverse effects on growth, revenue projections, collections of [Goods and Service Tax](#) (GST) resulting in friction between the center and states over the issue of GST compensation, which is constitutionally mandated.

Background:

- The arguments on the issue of GST compensation has become a matter of debate since August 2019 because of consistent delays in the payment of compensation to the states, disregarding the agreed norms of providing provisionally calculated compensation every two months.
 - The GST (Compensation to States) Act 2017 provides for a mechanism to compensate the states on account of loss of revenue due to the implementation of the GST, for a period of five years (2017-22).
 - This is in lieu of states ceding their power to levy an indirect tax to center, under the GST regime.
- Revenue shortfall in a particular year is calculated as the difference between revenue collection of that year and the revenue estimated by applying 14% growth on a compounded basis over the base year's (2015-16) revenue.
- Currently, the GST compensation fund is projected to face a shortfall of about Rs. 2.35 lakh crores.
 - The total revenue shortfall is estimated at Rs.3 lakh crores.
 - The GST fund is expected to have a cess balance of only ₹65,000 crores.

Central government's response:

- In the meeting of the GST Council held on 27th August 2020 to discuss the compensation issue, the center backed off from its promise to provide for the shortfall.

- The center argued that, of the projected shortfall of about Rs. 2.35 lakh crore, only Rs. 97,000 crore was due to the implementation of GST and the rest was due to impacts of the pandemic, which the chairman of the GST council and finance minister asserted, was an “[Act of God](#),” – a crisis independent of the implementation of the GST.
- The center proposed two options to states:
 - First was that the state can borrow the projected GST shortfall of Rs. 97,000 crores, after consulting [RBI](#).
 - The additional borrowing would not be accounted for as a part of the state’s debt for calculation of overall debt.
 - The repayment of the principal and interest on these borrowings would be made from the compensation fund by extending the period of cess collections beyond 2022.
 - Apart from this, a 0.5% relaxation in the borrowing limit under the [Fiscal Responsibility and Budget Management \(FRBM\) Act](#) would be provided delinked from the conditions linked to the implementation of reform measures.
 - Second, the states can borrow from the market, entire Rs. 2.35 lakh crore shortfall.
 - However, under this option, States would have to pay the interest rate and the compensation funds will take care of only the principal amount.

Response of the states:

- Non-BJP-ruled states, particularly Kerala, Punjab, West Bengal, Delhi, and Chhattisgarh have rejected both options.
- They have argued that it is for the center to borrow from the market and compensate the states.
- The assertion made by these states is due to the unconstitutionality of the proposals made by the center.
 - Section 18 of the Constitution (One Hundred and First Amendment) Act states that Parliament, on the recommendation of the GST Council, shall provide for compensation to states for the loss of revenue arising out of implementation of the GST for five years.

Conclusion:

- The states are entitled to the guaranteed compensation irrespective of the collections under the cess.
- The center is both morally and legally bound to compensate states. There is no point in states taking additional debt burden on themselves.
- As compared to states, the center has more power and resources.

- The Center can utilize different sources of revenue such as income tax, corporation tax, and customs duties which are more buoyant and are outside the GST regime.
- Besides this, center can also utilize non-tax revenues such as dividends from the RBI and central public sector units to compensate the states.
- States have limits on their borrowing capacities and have shared more burden than the center in fighting the pandemic.
- In such circumstances, the center must borrow on its own and compensate states.
- Only through this can the true spirit of cooperative federalism be upheld.

