SORRY STATE

GST cess may stay for 2 years beyond FY22

FE BUREAU
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THE CENTRE AND states will likely resolve the vexed issue of a yawning deficit in the GST compensation cess fund by resorting to market borrowings this year, and finance it by retaining the cess for a year or more beyond the current end date of FY22. The borrowing requirement could be around ₹2 lakh crore, according to an *FE* estimate. If the state agrees to settle for a lesser compensation given unforeseen circumstance created by Covid-19, then the borrowing size would reduce.

But what could become a bone of contention as the GST Council discusses the issue at its next session is who will borrow — the Centre or the states or the GST Council.

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### Yawning deficit (₹ cr)

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<th>FY18</th>
<th>FY19</th>
<th>FY20</th>
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<tbody>
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<td>T</td>
<td>62,611</td>
<td>69,858</td>
<td>1,65,302</td>
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<tr>
<td>Cess collected</td>
<td>41,146</td>
<td>69,275</td>
<td>95,444</td>
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<tr>
<td>Compensation released to states</td>
<td>21,465</td>
<td>25,806</td>
<td>95,851</td>
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April-July FY21

- Protected state revenue: ₹2.55 lakh cr
- Gross GST collected*: ₹2.57 lakh cr
- States' share 1.28 lakh cr (@50% of gross)
- Shortfall 1.1 lakh cr

Cess fund shortfall in FY21: Between ₹1.9-2.1 lakh cr

*Minus cess funds of ₹15,665 cr

[^FE estimate]
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ARMED WITH THE attorney general’s (AG) opinion that it is under no legal obligation to make up from its own coffers any shortfall in GST revenues of states from the ‘protected’ level, the Centre will want the states to raise the debt and service it out of the bolstered cess proceeds. But the states are unlikely to buy into the argument, as they fear that the debt will likely impose a cost on them. The compensation funds, after all, was supposed to be part of their income, sans any cost. Even the likely promise of a fiscal forbearance may not quite convince them.

Entrusting the GST Council with the borrowing obligation will require corporatisation of the entity. To cut the borrowing cost, loans to be raised by the Council will have to be under sovereign guarantee, meaning as contingent liabilities these could possibly raise the public debt. Also, a mechanism will need to be evolved on sharing of the borrowing costs between the Centre and states. The legal tenability of this option is open to contentions.

It is possible that the discord will finally be resolved in
the courts.

Since the overall borrowing limit by the Centre and states for FY21 has already been raised by 40% to a massive ₹22.69 lakh crore, and the Centre is still talking about giving another dose of fiscal stimulus to the economy by mid-year, the proposed additional government borrowings for the explicit purpose of states’ GST compensation would be much costlier to the exchequer – perhaps the costliest in history.

Of course, given the (reformist) conditions attached to utilisation of the extra borrowing space and for their own reasons of prudence, many states may not fully use it. But that is barely a solace, as overall government borrowings will still be high enough to overcrowd the market, despite the robust systemic liquidity. Also, banks will be wary about subscribing to bonds issued by states, given that many of them are fiscally very weak.

Though there are supplementary options to bolster the compensation fund, including levying the cess, now applicable to specified ‘sin and luxury goods’ on more items and making it ad valorem in all cases, these are not immediately viable due to the deep economic slump. Some states, however, may also seek to innovatively use the non-GST revenue space opportunistically, over the course of this year to strengthen their own tax receipts.

As part of the grand bargain struck between the Centre and states prior to the GST’s implementation, the GST (Compensation to States) Act, 2017, provided for a protected revenue growth of 14% over the base year of 2015-16 during the transition period (first five years of GST) to states. It is now clear that the Centre, guided by its dogged determination to roll out the epochal tax reform, was too generous in giving states this assurance. It could have made the relief receptive to GDP growth, at least.

The overall GST revenue growth was just 3.8% in FY20; most likely, the growth would be negative in the current fiscal year. Though one reason for the GST revenue growth being below expectations is the slower-than-expected economic growth rates since its introduction, it may be noted that the tax was much less comprehensive than envisaged, for it to bring about the desired-for revenue productivity. Also, the GST was launched with its weighted average rate being significantly below the
revenue neutral rate estimated; a series of rate cuts by the GST Council and the below-optimal efforts at plugging revenue leakage/evasion indeed widened the gap.