PRESS MONITOR

The Hindu, Delhi
Thursday, 29th July 2021; Page: 7
Width: 21.54 cms; Height: 48.75 cms; a3; ID: 25.2021-07-29.63

Oxygen for fiscal federalism

A special rate could be levied to the States to enable them to raise more resources during the pandemic

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James Madison, who created the basic framework for the U.S. Constitution, once said, "The powers delegated by the proposed Constitution to the federal government are few and defined. Those which are to remain in the State governments are numerous and indefinite."

But Indian federalism is very different. The British lawyer and academic, Sir Ivor Jennings, was of the view that India has a federation with a strong centralising policy. Nonetheless, India maintained its limited federal characteristics for a fairly long time. Those characteristics are now disappearing in the Modi era.

Disregarding an obligation

At the time of introducing the new indirect tax regime, the Goods and Services Tax (GST) law assured States a 14% increase in their annual revenue for five years (up to July 1, 2020). But the Union government has deviated from the statutory promise and has been insisting that States avail themselves of loans. Kerala is entitled to a GST compensation of ₹4,041 crore for the financial year 2020-21. But the Union government has been disregarding this obligation. The future interest liability of these loans should not be placed on the shoulders of the States. Moreover, the borrowing limit of States, as per the Fiscal Responsibility and Budget Management Act, should not be built into these loans. This policy needs clarity.

Last year, the Union government increased the borrowing ceiling of the States from 3% to 5% for FY 2020-21. But conditions are attached to 1.5% of the 2% of increased ceiling. It is the States which have to bear the burden of welfare and relief measures during the pandemic. Attaching conditions for expenditure out of the borrowed amount would clip the wings of the States and goes against the principle of cooperative federalism.

The Fifteenth Finance Commission had recommended ₹2,412 crore as a sector-specific grant and ₹1,100 crore as a State-specific grant for Kerala. But the Union government has not taken any steps to release these amounts. The expenditure rules attached to the Disaster Management Fund are unviable. The rules could be amended to ease expenditure. The Corporate Social Responsibility Fund could be remitted to the Chief Minister's Relief Fund.

As per the Constitution (One Hundred and First Amendment) Act, compensation on account of the implementation of GST will be available for a period of five years. Compensation beyond five years requires a constitutional amendment. The GST Act says it is a law to provide for compensation to the States for the loss of revenue arising on account of the implementation of the GST for a period of five years or for such period as may be prescribed on the recommendation of the GST Council.

Urgent measures

The present compensation period will end in 2021-22. Beyond this period, it is going to be very difficult to convince the Union government to provide compensation as there is no constitutional obligation to do so to the States. This will create serious financial stress to the States, especially to those which require higher compensation.

As per Section 4(f) of Article 279A, the Union government can consider introducing any special rate to raise additional resources during the pandemic (any natural calamity or disaster). Section 4(f) says: "The Goods and Services Tax Council shall make recommendations to the Union and the States on – Any special rate or rates for a specified period, to raise additional resources during any natural calamity or disaster". Article 279A was inserted through the Constitution (One Hundred and First Amendment) Act.

Hence, a special rate could be levied for a specified period in order to raise additional resources to meet the challenges posed by COVID-19 with the approval of the GST Council. These are some urgent necessary measures that are to be taken for pumping oxygen to fiscal federalism in India.

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