

GST and the complexity of political negotiations



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With the Centre's actions in the COVID19 phase affecting the federal architecture, the danger lies in States following suit

Over the last couple of months, the Centre and States have not been on the same page over issues connected with the Goods and Services Tax (GST). As a result, Centre State relations have plumbed the depths. This tussle, between the Centre and the States is, however, not uncommon and all federations witness bargaining in some form or other. A diversity of interests is the badge of federalism, and there will be constant negotiation and renegotiation. It is this tension that keeps a federation ticking.

Called one of the most significant fiscal reforms since Independence, the GST replaced numerous central and State taxes with a one single destination based tax. The Constitutional Amendment overhauled Centre State relations, with States giving up almost all their powers to tax. In exchange for this bargain, the Centre assured them full compensation, for five years, for all losses arising due to the transition to the GST. A GST Council, made up of the Central and State Finance Ministers, was established and empowered to make recommendations about various issues related to the GST.

UNDER STRAIN

This grand federal bargain was severely tested this year following the general economic slowdown and the COVID19 pandemic induced disruption. Tax collections plummeted which in turn have led to a massive revenue shortfall. In turn, this has also reduced the available resources in the compensation fund. With the GST in place, the Centre held the whip hand and with limited abilities to raise revenues. The States in turn were left staring at a bad deal. The crisis and the unequal relationship created an incentive for the Centre to blur the lines. The Centre it appeared was no longer committed to the agreement and wanted to overturn parts of the deal that were “unfavourable” to it, creating an immense strain on the fragile consensus.

The GST Council strategy

The Centre was averse to providing succour, and when it did, it came with strings attached. For instance, in May 2020, it linked the increase in the fiscal deficit of States from 2% to 3% to reforms in four areas including universalisation of a ‘One Nation One Ration Card’, electricity distribution, ease of doing business, and urban local body revenues. Similarly, on Compensation, the initial noises were that it was not obligated to make good the compensation losses. Most States preferred that the Centre should borrow the entire shortfall and then lend it to States, while the Centre wanted the States to borrow the money directly. The GST Council meetings during this period did not help reduce the trust deficit and break the deadlock but only added fuel to the fire. States had no clue of what the Centre was thinking as there were no

statements of intent at the Council meetings. For example, the Finance Minister of Kerala complained that decisions were not being made in the Council but announced subsequently in press meetings.

The disinclination to use the Council was deliberate and intended to prevent “unionised bargaining” by the States. At the same time, by working outside the Council, the Centre was able to exploit asymmetries and divisions between States. In August 2020, States were offered two options to borrow money to meet the shortfall. When a sufficient number of States accepted one of them, the Centre argued that this was the favoured solution. The States, especially those ruled by the Opposition parties, were reluctant to accept this offer and stuck to their preferred position until the Centre finally relented in October. The friction not only shook the foundations of the GST, with at least one State threatening to go to court over the issue, but also exposed the hollowness of the Centre’s hype around cooperative federalism.



The puzzle is why the States agreed to move authority in determining Budget spending (Fiscal Responsibility and Budget Management Act earlier) and setting tax rates (value added tax, or VAT, first and GST now) and in the process shrink their discretionary space to manage their financial affairs. The shift is counterintuitive, especially since we expect States to protect their autonomy vigorously, and in fact attempt to enlarge their scope. Economic and fiscal federalism scholarship offers us reasonably sound economic and normative reasons for this shift, which include efficiency, equity, stabilization, economic growth, and balanced development, among others. However, this logic does not make political sense and does not help understand the current new low in the relations between the Centre and States.

POLITICAL LINKAGES MATTER

I argue that the nature of the party system and party linkages matters in Centre State relations. In the period of Congress dominance, States had few issues when economic management was centralized in the name of development. Their concerns and grievances, if any, were taken up through intraparty channels. The Congress ruled States went along with the central government given that the locus of power in the party was not at the State level but the Centre. Dissent against centralization appeared only when non Congress parties consolidated their position.

The period towards the end of the one party dominance was especially fractious, and government Opposition relations increasingly coloured Centre State relations. To check its competitors, the Congress used (and misused) every available means, including, the use of Article 356, the institution of the Governor and discretionary central grants among others to continue its dominance.

In sharp contrast to the one party dominant phase, the coalition era inaugurated a seemingly more cordial period of Centre State relations based on a recognition of mutual interests. In federal coalitions, States and their interests were made to feel that they were being

represented. Ironically, it was during this period, when State based parties called the shots that much of the authority migration began.

Former Finance Minister Yashwant Sinha in his memoirs underlines how the Centre chose to remain out of the limelight, and an empowered group of State Finance Ministers helped bring about VAT, the precursor to GST. The GST reforms also followed the same pattern. This decision making process gave States both the confidence and ownership of reforms and the new institutions being put in place. State based parties probably assumed that they would continue to influence national level decision making through the new institutions or through coalitions.

It follows that authority migration towards the Centre might not make a difference to States/parties if their interests appear to be taken care of by the Centre/party. Party linkages between levels give State level politicians greater space. In a polity wide disciplined party, acceding to the central government's demands may secure the career prospects of State level leaders. Similarly, for State based parties, there is access to resources and the possibility of influencing national level decisions through federal coalitions.

The greater the degree of party centralisation, the higher the possibility of federal centralisation. This explains why the Congress ruled States did not make a noise during the one party dominant phase, and the Bharatiya Janata Party ruled States do not do so today. Party linkages between different levels of government are crucial to both the making and the maintenance of federal compacts.

UPHOLD THE PLAYER RULES

The GST agreement also illustrates the complexity of political negotiations. The bargain quite naturally could not have foreseen 2020. More importantly, the nature of the relationship between the actors involved has changed. From a period in which State based parties had heft, we now have a one party formation calling the shots. All institutional arrangements we know have winners and losers; while the winners attempt to maintain status quo, the losers will attempt to overhaul the existing state of affairs. While the States are negotiating within the agreed framework, the Centre's actions undermine the federal architecture. If this happens consistently over time, there is nothing to stop the States also from doing so.

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