



## GST and Fiscal Federalism

**This editorial is based on [“The Business of Federalism”](#) which was published in Indian Express on 21/05/2022. It talks about the challenges that the Goods and Services Tax poses to India’s fiscal federalism.**

**For Prelims:** Federalism, GST, PRAGATI Initiative, Cooperative Federalism, Centre-State Relations, NITI Aayog, GST Council

**For Mains:** Challenges to India’s Fiscal Federalism, Issues in GST Regime, Need to promote positive competition among states for economic growth

The ongoing discords between the [Centre and states](#) over **issues ranging from the allocation of financial resources to fixing of [Goods and Services Tax \(GST\)](#) rates** has once again brought to the fore issues pertaining to our federal structure, the resolution of which is essential for the country’s growth.

The traditional approach to federalism that sees competition and cooperation at loggerheads is no longer relevant in the post-1990s scenario. A **combination of cooperative and competitive spirit ensures the economic prosperity** and welfare of the nation in an equal and equitable manner.

The rising stature of the Indian economy on the world stage can only be strengthened by a tailored approach to cooperation and competition.

### What do We know about Federalism?

- **Federalism** in essence is a dual government system including the Centre and a number of States. Federalism is one of the pillars of the [Basic Structure of the Constitution of India](#).
- A Federal theorist **K.C. Wheare** has argued that the nature of Indian Constitution is **quasi-federal in nature**.
  - The Supreme Court, too, in **Sat Pal v State of Punjab and Ors (1969)**, held that the Constitution of India is more Quasi-federal than federal or unitary.
- The respective **legislative powers of states and Centre** are traceable to **Articles 245 to 254** of the Indian Constitution.

### What are the Recent Efforts to Promote the Spirit of Federalism?

- Recent efforts in this direction include providing **greater leeway to states in the functioning of the [NITI Aayog](#)**, frequent meetings of the Prime Minister with the Chief Ministers and periodic meetings of the President of India with [Governors](#).
- The **functioning of [“PRAGATI”](#)** to review the progress of developmental efforts has also generated the requisite synergy between the Centre and states.

## What are the Challenges Posed by States regarding GST?

- The GST has **taken away much of the autonomy** available to states and has **made the country's indirect tax regime unitary in nature**.
- After the introduction of the GST in 2017, state governments **lost their independent taxation powers**.
  - **Liquor and fuel are the only two significant avenues left for states** to generate their own tax revenues, without having to seek approval from the Union government, since they are outside the GST regime.
- India's **GST is precariously held together by the loose thread of "compensation guarantee"**, under which states surrendered their fiscal powers in return for guaranteed revenues.
  - However, during the Covid-19 pandemic, the Union government repeatedly **violated the [compensation guarantees to the States under the GST regime](#)**. Delay in paying the States their due worsened the impact of the economic slowdown.
  - The GST compensation period expires in June 2022, and despite multiple requests from the States, the **deadline has not been extended**.

## What is the SC's Recent Judgment about Federalism regarding GST?

- Recently, the Supreme Court in a judgment invoking the spirit of **"Cooperative Federalism"** for the well-being of democracy, held that **Union and State legislatures have "equal, simultaneous and unique powers"** to make laws on **[Goods and Services Tax \(GST\)](#)** and the **recommendations of the GST Council are not binding on them**.
  - The apex court's decision came while confirming a Gujarat High Court ruling that the Centre cannot levy **Integrated Goods and Services Tax (IGST)** on ocean freight from Indian importers.
- In simple terms, Parliament and State Legislatures have simultaneous powers to legislate under the GST.

## What can be the Way Forward?

- **A Reformed Approach toward States:** The Centre could strive to be **more conciliatory towards States' concerns** and fiscal dilemmas.
  - The **Council should also meet more often** to nurture the critical fiscal federalism dialogue in the right direction and minimize trust deficits.
  - There are many **pending reforms** that require the Centre to work more cohesively with States to take India's economy forward and lift those left behind - **land, labor markets as well as the agrarian sector**.
- **Horizontal and Vertical Level Cooperation:** Cooperation between the Centre and states is required at both vertical (between Centre and states) and horizontal (among states) levels and on various fronts.
  - This includes **fine-tuning of developmental measures** for desired outcomes, development-related **policy decisions, welfare measures, administrative reforms, strategic decisions, etc.**
- **Reforms in GST Council:** It may be time already for reform of the GST. What is needed is **statesmanship at the GST Council** even if the Court has said that the Council is a place as much for political contestation as for co-operative federalism.
  - The Council should **transcend political rivalries** of the day.
  - The States should have the **[right to dissent in the Council](#)** and their voice should not be drowned in the pursuit of unanimity in decision-making.

## How and Why Should Positive Competition be Promoted?

- **How:**
  - The competitive aspect of federalism can positively be harnessed by **encouraging states to adopt each other's best practices**. This positive competition can be ensured vertically as well as horizontally.

- Positive efforts of states towards attracting investment can create a conducive environment for economic activities in urban and backward regions alike.
  - Healthy competition coupled with a **transparent ranking system** would ensure the full materialization of the vast but least utilized potential of the federal framework.
    - Healthy competition among states would also help them **innovate and generate the requisite synergies for local businesses.**
- **Why:**
- Adoption of best practices and implementation of reforms at the ground level would **positively impact the [ease of doing business for MSMEs](#).**
  - This would **raise India's manufacturing capacity** to the next level and radically transform India's growth story.
  - The **rise in economic activities would result in higher GST collection** and thereby boost the government's welfare measures.
  - Competition among states along with hand-holding by the Centre has the potential to enable the **realization of the goal of a five-trillion economy** by 2024.
- **Related Initiative:**
- To promote positive competition among states NITI Aayog's sector-specific indices have proven to be a great contribution. Such indices are:
    - **[School Education Quality Index](#)**
    - **[Sustainable Development Goals Index](#)**
    - **[State Health Index](#), [India Innovation Index](#)**
    - **[Composite Water Management Index](#)**
    - **[Export Competitiveness Index](#)**

#### ***Drishti Mains Question***

"It is undeniable that cooperation is key to the smooth functioning of federal design of a country. However, if it is coupled with positive competition among the states, then the overall result would be large-scale economic development across the country". Comment.

### **UPSC Civil Services Examination, Previous Year Questions (PYQs)**

**Q. Which one of the following in Indian polity is an essential feature that indicates that it is federal in character?**

- (a) The independence of judiciary is safeguarded.
- (b) The Union Legislature has elected representatives from constituent units.
- (c) The Union Cabinet can have elected representatives from regional parties.
- (d) The Fundamental Rights are enforceable by Courts of Law.

**Ans: (a)**

**Q. Which one of the following is not a feature of Indian federalism? (2017)**

- (a) There is an independent judiciary in India.
- (b) Powers have been clearly divided between the Centre and the States.
- (c) The federating units have been given unequal representation in the Rajya Sabha.
- (d) It is the result of an agreement among the federating units.

**Ans: (d)**

**Q. Local self-government can be best explained as an exercise in (2017)**

- (a) Federalism
- (b) Democratic decentralization
- (c) Administrative delegation
- (d) Direct democracy

**Ans: (b)**

**Q. Consider the following items: (2018)**

1. Cereal grains hulled
2. Chicken eggs cooked
3. Fish processed and canned
4. Newspapers containing advertising material

**Which of the above items is/are exempted under GST (Good and Services Tax)?**

- (a) 1 only
- (b) 2 and 3 only
- (c) 1, 2 and 4 only
- (d) 1, 2, 3 and 4

**Ans: (c)**

**Q. What is/are the most likely advantages of implementing 'Goods and Services Tax (GST)'? (2017)**

1. It will replace multiple taxes collected by multiple authorities and will thus create a single market in India.
2. It will drastically reduce the 'Current Account Deficit' of India and will enable it to increase its foreign exchange reserves.
3. It will enormously increase the growth and size of economy of India and will enable it to overtake China in the near future.

**Select the correct answer using the code given below:**

- (a) 1 only
- (b) 2 and 3 only
- (c) 1 and 3 only
- (d) 1, 2 and 3

**Ans: (a)**

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