GST compensation to states

October 17, 2020

The GST Council has failed to reach an agreement on the contentious issue of borrowings to meet shortfalls in cess collections to recompense the States for revenue losses from implementation of GST. However the Centre is ready to help the States who have decided to borrow to bridge the cess shortfall. Though many states have agreed for the proposal, the move of dissenting states is yet to be known.

In news: The Centre has allowed 20 states to raise Rs 68,825 crore through open market borrowings to meet the shortfall in the compensation cess under GST.
Placing it in syllabus: Goods and Service Tax (GST)
Dimensions

1. Options given to states
2. GST council and failed consensus

Content:

Options given to states:

- The **Department of Expenditure, Ministry of Finance,** has granted permission.
- The Centre took this step after the GST council failed to decide on the issue.
- This provision is for the **states that have chosen the first of two options** suggested by the government to meet the shortfall arising out of GST implementation.
- Additional borrowing permission has been granted at the **rate of 0.50% of the Gross State Domestic Product (GSDP).**
- The projected total compensation shortfall in the current fiscal stands at ₹2.35 lakh crore.
- The Centre had in August, 2020 had given two options to

the States –

to **borrow either ₹97,000 crore from a special window facilitated by the RBI** (Centre has contended that the balance ₹1.38 lakh crore is attributable to an ‘act of God’ (the COVID-19 pandemic) that is independent of implementation of the new indirect tax regime) **OR**

to borrow **₹ 2.35 lakh crore from the market** (here the interest cost would have to be borne by them with only the principal being serviced by the Compensation Fund).

- **Now, under the first option, states have been allowed to borrow Rs 1.1 lakh crore from the market.**
- This **will be serviced from the compensation cess that has been extended beyond the originally agreed five-year tenure that ends June 2022.**
- The **borrowing states are** Andhra Pradesh, Arunachal Pradesh, Assam, Bihar, Goa, Gujarat, Haryana, Himachal Pradesh, Karnataka, Madhya Pradesh, Maharashtra, Manipur, Meghalaya, Mizoram, Nagaland, Odisha, Sikkim, Tripura, Uttar Pradesh and Uttarakhand.
- The states will also be provided **a special window to borrow the amount** through the issue of debt.
- Some of the states have asked the Centre to set up a committee of officers to formalise the modalities of availing the Rs 1.1 lakh crore.
- The committee should provide details of the borrowing mechanism including loan tenure and repayment terms under the only funding option that is now available.
- The **second option was scrapped as no state showed interest in it.**
- The **Centre has also waived the reform conditions** that had been imposed on borrowing the final instalment of the 0.5% of GSDP out of the 2% additional borrowings permitted in view of the Covid-19 pandemic for states that choose the first option.

Compensation bonds:

- As the states sell debt securities in the market to raise Rs 1.1 lakh crores, the Centre will keep the interest cost on these borrowings "at or close to" the yield on G-Sec (bonds issued by the Government of India).
- In the event of the cost being higher, the centre bears a part of the difference through a subsidy.
- This additional borrowing by the States will not be accounted for as a part of the State's debt for purposes of its overall debt calculation.

GST council and failed consensus:

- The move has triggered a confrontation with the opposition ruled states that have rejected both the options offered by the centre.
- Ten states – Bengal, Kerala, Punjab, Delhi, Jharkhand, Chhattisgarh, Telangana, Andhra, Rajasthan, and Puducherry are against the Centre's proposal.
- The states have also opposed Centre's insistence that the shortfall be met through their own borrowings from the market.
- They have retorted that since meeting the shortfall is the Centre's binding commitment, it ought to borrow to compensate them.
- States have refused to accept a borrowing plan that would stretch their already beleaguered finances, especially as they battle the pandemic.
- States have complained that heaping additional borrowing costs on them would leave them extremely vulnerable.
- West Bengal and Chhattisgarh strongly opposed the Centre's move while Assam and Goa wanted permission to avail themselves of the loan without the GST Council taking a decision.
- Dissenting states have planned to jointly approach the Supreme Court if the Centre goes ahead and allows States

to borrow up to ₹1.1 lakh crore from a special window facilitated by the RBI.

Mould your thought:

1. Explain the recent proposals by the centre to states to meet their revenue shortfall in the compensation cess under GST. Why are certain states dissenting the proposal?

Approach to the answer:

- Write the two options given to states
- Explain the recent proposal of GST council meeting
- Explain why some states are against it