

## Indian Federalism in the Era of GST

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**Abstract:** Prime Minister Narendra Modi's statement after his victory in May 2014 elections that his government is serious about restructuring centre-state relations and strengthening the principles of cooperative federalism. The strongest decision in this regard was made when the new government announced the dissolution of the Planning Commission and second is India's biggest tax reform-Goods and Services Tax (GST) Bill that has been recently passed by government. The GST is expected to usher in a uniform tax regime across India through an expansion of the base of each into the other's territory. The road to the GST is still strenuous. Some made objections on that it will usurps over the tax-levying powers of the states and thus making a serious threat to federalism which is the basic structure of the constitution. Other argues that it must be hailed instead of opposing for it opens the path of development for the country. This paper is an effort to evaluate the effects of GST on Indian economy and on the center-state relations. An attempt also has been made in this work to find out the obstacles in the implementation of GST on Indian economy with some possible solutions.

**Keywords:** Liberalization, Economic Relations, Services, Federalism, Cooperation.

### INTRODUCTION

Federalism constitutes a complex governmental mechanism for governance of a country. It has been evolved to bind into one political union several autonomous, distinct, separate and disparate political entities or administrative units. It seeks to reconcile unity with multiplicity, centralization with decentralization and nationalism with localism [1]. Although India does not have the same federal system as other federal countries like USA, Canada, Switzerland or Australia have and is often called quasi-federal. It provides for a dual system of governance with a powerful central government/ union. Even during emergency Indian constitution become unitary in character and in case of conflict between union and state law prevails. Not only this but India has a single judicial system and there is only one constitution of India that is sovereign and supreme.

But the three cross-cutting developments, namely the rise of regional political parties, globalization and liberalization of the economy have deeply influenced the manner in which the concept of federalism is perceived today from what was originally envisaged by the framers of the Indian constitution [2]. The rapid decline of the Indian National Congress in the 1960s led to an upsurge of regional politics and brought key principles of federalism under intense scrutiny. The dramatic collapse of one-party dominance or the "congress system" and the simultaneous rise of

coalition governments and regional parties triggered a dramatic shift in federal relations, resulting in states gaining a greater voice and more political autonomy. The center of gravity has shifted considerably towards the states and regional parties. Despite the present ruling party BJP has majority in the Lok Sabha, it depends heavily on regional parties as they currently dominate the Upper House of Parliament. The net outcomes of these changing political equations are that the existing principles which govern centre-state relations are increasingly being contested by the regional players [3]. Similarly, the shift from a public sector-dominated economy based on import-substitution industrialization to a private sector-dominated market economy dramatically changed the dynamics of center-state relations. Economic reforms changed not only the macroeconomic policy framework, by assigning a greater role to the market, they also redefined the role, quality and instrumentalities of government intervention at all levels. Private sectors investments directly began flowing into states and market mechanisms determined development factors like infrastructure and services at the state level. Economic liberalization has brought unprecedented prosperity to some states that once depended on central grants and concessions; these states including Gujarat, Tamil Nadu and Maharashtra [4]. The decentralization of federalism has been further aided by the role played by an "activist" judiciary since the early 1990s. The Supreme Court of India

understands federalism to be an important constitutional principle. In the much famed *Kesavanand Bharti v. Union of India* (1973) case, Justice Sikri held that federalism was a part of the basic structure of the Indian constitution, implying that a constitutional amendment cannot violate the principles of federalism. Also, in *S.R. Bommai v. Union of India* (1991) the Supreme Court held the importance of Indian federalism, ruling that a state emergency would fall under the ambit of judicial review. More recently, in the *Nabam Rebia v Deputy Speaker* (2016) case, the Supreme Court quashed the state emergency in Andhra Pradesh up-holding federalism [5].

These developments added new dimensions to centre-state relations, brought newer stresses and tensions in federalism and opened up a fresh debate on many issues. Prime Minister Narendra Modi's statement after his victory in May 2014 elections that his government is serious about restructuring centre-state relations and strengthening the principles of cooperative federalism. The strongest decision in this regard was made when the new government announced the dissolution of the Planning Commission and second is India's biggest tax reform-Goods and Services Tax (GST) Bill that has been recently passed by government. The GST bill is considered as the most important financial changes that have been brought in country since that of 1991 economy reform. GST is very similar to VAT (Value Added Tax) as the multistage comprehensive taxation which includes both goods and services. In a federal country like India constitution provides for the division of taxation power between the centre and states, currently the indirect taxes are collected from goods and services that include excise duty, sales tax, services tax etc. are levied and collected by the centre and states. The tax collected by the states varies from one state to another [6]. It is certainly true that right to taxation is intimately linked with the right to decide on the rate of taxation. Post GST, individual state government would not be able to decide on the rate structure of GST in a particular state. That way for the sake of tax harmony, fiscal autonomy is compromised. This is true for the central government as well. Centre also cannot change anything without the approval of the majority of the states in the GST council. But if we examine the big picture, in a globalizing world, fiscal policy, especially tax policy has become in a way ineffective long back. To give an example, to attract global investment, India has not a corporate income tax rate which is way above the rates in other emerging market economies trying to attract same investment. The same thing is being reflected here, i.e. a process of harmonization of tax rates across the country through a process of negotiation in the GST council. In the former case, it is the market that forces a country to align rates to a particular reference in the latter case it is happening through a process of negotiations [7].

Central and State taxes to be subsumed under GST are the following:

- a) The Central taxes would include central excise duties, additional duties of excise, additional duties of customs, special additional duties of customs, service tax and central cesses and surcharges so far as they relate to supply of goods and services.
- b) State taxes to be subsumed under GST are State VAT, central sales tax, luxury tax, entry tax, entertainment tax, taxes on advertisement, purchase tax, taxes on lotteries, betting and gambling and state surcharges and cesses so far as they relate to supply of goods and services.

Owing to Indian federal structure, GST is dual, levied and managed by different administrations. Centre would levy and collect Central Goods and Services Tax (CGST), and states would levy and collect the States Goods and Services Tax (SGST) on all transactions within a state. And the rates for CGST and SGST will be administered by the GST council which is neither an agent of State nor of Centre.

#### **GST: Cooperative Federalism or a blow against Federalism**

Some argue that GST Bill is against the basic principle of Indian Constitution. It will ring the death bell of the federalism in India. Without federal powers to decide taxes according to their necessities, States will have to come with a begging bowl to the Centre frequently. This will in turn start the process for a Presidential or an authoritarian rule of the Centre as is being envisaged by the BJP and its ideological fountainhead, the Sangh Parivar. The essence of a federal policy is that different political parties can hold power in different states and at the Centre, and they should be able to pursue their different programmes in keeping with their divergent ideologies. For doing so, however, they should have the freedom to pursue their preferred fiscal policies: while some may provide incentives to corporate capital to invest in the state, others may raise their tax rates to garner larger revenue for undertaking more welfare expenditure; while some may enforce complete prohibition, thereby losing revenue for the sake of pursuing what they believe to be a laudable objective, others may use this very source for raising revenue for what they consider worthwhile programmes. No doubt the revenue sources available to state governments are limited; they are dominated by the sales tax which fetches close to 80 per cent of the revenues for most states. But in the matter of sales tax rates, the states did have a degree of freedom. The GST is trying to reduce that freedom [8]. The worries of the manufacturing states have not been addressed properly by the union government. The revenue loss compensation assured by the union government for a specific period is a rocket booster, but it is doubtful that the proposed GST vehicle would launch the manufacturing states in the revenue

trajectory they are travelling in now, especially after the booster runs out. If there is a failure in this mission, with no independent powers of taxation, such states may be left in the lurch. Similarly, taxation powers cannot be viewed only as a measure of resource mobilization. It could be used as a tool to control and restrict the consumption of some goods for social good. For example, Tobacco products generally attracts huge tax rate as a measure to control the consumption on health grounds. Here tobacco producing States argue for lesser taxes for maximum sales and the Consumer States will demand for leverage for fixing higher taxes. Health concerns ratify the higher rate of tax on tobacco. Whose interest the Centre will protect, when the regime of uniform tax rate comes? Likewise if a state government needs an additional resource mobilization for facing a natural calamity, it cannot decide for any special levy. Swachabharat and other Central schemes can only be decided and used by the Central Government. "Make in India" Programme is focused for strengthening and protecting the domestic industry from foreign import. Likewise, state governments have to protect local industry and employment. For this objective lesser sales tax and other incentives is needed for helping local producers. But the right of state governments for variable taxation will end with the introduction of GST regime [9]. The next major concern is that the GST distorts the basic structure of fiscal federalism provided in the Constitution. The proposed GST Council would become another institution for politicking rather than a rational think tank on indirect taxation.

But all the criticisms are not whole true. GST bill ultimately protect the rights of the citizens from "double taxation". The most important benefit of GST is it will increase the revenue of poor states like Bihar, Uttar Pradesh, Orissa- who happen to have the larger consumers. GST bill will increase the resources available for poverty alleviation and development. Secondly, then with the introduction GST will boost "Make in India" programme because under GST markets are unified. GST bill proposes to create the concurrent taxation power between the centre and states, which itself a good example of cooperative federalism. The GST will make the center and states equal partners in the field of indirect taxation, through the GST council the states will have a serious role in fixing the GST rates, in resolving the dispute regarding its recommendation etc. So, GST will be the most powerful federal council in the independent India [10]. Both, Parliament and State legislatures will have the power to make laws on the taxation of goods and services. A law made by Parliament in relation to GST will not override a state law on GST. *This again emphasizes on the need of not worrying about federalism being undermined.* The aim of GST is not to promote competition, but to bring equality among the states which can be brought by avoiding wasteful competition between the states. For instance many

States have become manufacturing-hubs by easing their taxation policies and decreasing effective tax rates thus; attracting more and more investments and those which could not lagged behind. However, the introduction of a unified tax system will discourage this practice of 'beggar thy neighbor'. Thus, chances are that it may lead to redistribution of manufacturing activities amongst the States promoting equality among them and ultimately, preserving as well as promoting the federalism in India. No doubt that political autonomy of States is being taken away partially as the States themselves will not be able to decide as to where to use their revenue but national interests are more important to state interests. One must give a chance to GST to function, GST council to be formed and then, the results will wholly depend upon how efficiently the council functions and how carefully the new laws are implemented.

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