

Pranab Mukherjee's parting gift stumps PMO; Rs 20,000-cr compensation to states put on hold

For a few weeks before he stepped down as finance minister to formally join the presidential contest, Pranab Mukherjee took care not to clear any important files, following a time-honoured ministerial tradition of not lading successors with the burden of one's decisions. But one of his last few 'routine' decisions may have landed the Prime Minister's Office, which is for now overseeing the finance portfolio, on the horns of a dilemma.

On the eve of his resignation, Mukherjee cleared about Rs 20,000 crore in compensation dues to state governments in lieu of their phasing out the central sales tax (CST), one of the key steps in the move towards the goods & services tax (GST) regime that aims to replace a plethora of central and state indirect taxes with a single nationwide levy.

A finance ministry official said Mukherjee had signed the compensation papers a day before he resigned, after a request from Bihar's Deputy CM Sushil Modi, who also heads the empowered committee on GST, to settle the issue before he demitted office. "He (Mukherjee) was particularly keen to remove any hurdle coming in the way of GST," the official said.

Tightrope Walk for Manmohan

But Mukherjee had only allocated a sum of Rs 300 crore towards this head in the budget for 2012-13, which means that his successor— Prime Minister Manmohan Singh, who holds charge of the finance ministry now—will have to figure out how to rustle up the remainder to make good the promise at a time the government's fiscal position is already very stretched.

The prime minister, no stranger to braving hard economic spots, must now find a way to placate the states while he tries to keep the impact of the compensation on government finances to the minimum. "The (CST) issue is with the Prime Minister's Office," said an official privy to the matter.

A strong commitment and performance on fiscal consolidation by the government is a must for the Reserve Bank of India (RBI) to cut rates, but equally crucial is getting state governments on board to support GST, which has been billed as a landmark tax reform measure that aims to create an integrated national market for goods and services.

The states have set an August 7 deadline to settle the issue and have warned that if they are not compensated, they may not support GST. The introduction of GST is a nonstarter without the support of states. Presently, the central government collects CST, levied on inter-state sale of goods, and distributes it to states.

Both the Centre and the states had agreed to phase out the tax from April 2007 over a period of three years, and consequently the CST rate was reduced to 3% and then to 2%, as a precursor to GST. States received Rs 6,393 crore as compensation for cuts in central sales tax from the Centre in 2010-11.

But Mukherjee allocated just Rs 300 crore in this year's budget, saying that states had not delivered their part of the deal to help roll out GST. The total compensation dues for the previous two years—2010-11 and 2011-12—amount to about Rs 20,000 crore. Even a tempered compensation bill would impact government finances, already under pressure from a possible spike in subsidies that are pegged at Rs 1.79 lakh crore for 2012-13.

Analysts, many of whom are already skeptical of the government meeting its fiscal deficit target of 5.1% of GDP for 2012-13, say a Rs 20,000-crore expenditure on CST could push the deficit target further out of reach. "It would impact the fisc... But the more important issue is the contention between the Centre and the states," said Sunil Sinha, head economist at Crisil.

Analysts say the prime minister faces a tightrope walk—he can neither be seen as derailing GST nor does he have the luxury to let the fiscal deficit slip at a time the government needs to show urgent action on containing it. One option is to increase the sales tax rate, but it could be seen as a retrograde measure at a time investor sentiment is already fragile. States have suggested reverting to the old rate of 4%, but at a time the economy is slowing, that may be seen as undesirable.

Meanwhile, the pressure on the PM to do something is mounting. Bihar's Deputy CM Modi said he has written to Singh conveying the sentiments of states and has sought an urgent solution to the CST compensation issue. "States have been very agitated about the compensation issue," Modi told ET.

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