States On The Edge

The lockdown’s wrecked state finances. They need help to fight the pandemic and restore economic vitality

Reopening of liquor vends after weeks of lockdown resulted in predictable chaos. In city after city, social distancing norms broke down and police intervened. Yet, states are disinclined to shut them down again and the Delhi government even used the explosion of pent-up demand to levy a 70% special corona fee on the selling price of alcohol. If state governments appear as desperate as tipplers there’s reason. The episode encapsulates a fiscal crisis confronting states – exacerbated by the unnecessary ban on alcohol during earlier phases of lockdown – and the stress it will put on cooperative federalism.

States are at the cutting edge of development initiatives. They employ about five times more people and spend about one-and-a-half times more than the Centre. They also account for around 66% of overall government capital expenditure. Therefore, the health of state finances has a far reaching influence on the welfare and economic opportunities of Indians. At present, state finances are in dire straits on account of the lockdown. About 35% of their revenue comes from GST collection which has evaporated in the last six weeks. With no other options left in their toolkit, they have begun to raise taxes on fuel and alcohol, which contribute about 12% and 8% respectively of their revenue.

It doesn’t help to raise taxes when the economy is sliding fast. Nevertheless, Delhi and Tamil Nadu governments have either raised taxes or restructured them in a desperate bid to arrest falling revenues. Very likely, other states will follow suit as the economic costs of the lockdown mount. As yet, the central assistance they have received has been underwhelming. India has perhaps the most stringent lockdowns among major economies and also the most anaemic fiscal response to the economic fallout. This cannot but have an adverse impact on cooperative federalism, all the more necessary when the country confronts a pandemic.

The pandemic, according to RBI governor Shaktikanta Das, has been superimposed on an economic slowdown. The combined impact will make state finances a mess. This mess will follow earlier friction between some states and the Centre over compensation for shortfall in GST collections. This could morph into politicisation of the fight against Covid-19, which must not be allowed. The Centre should now quicken its fiscal response. The longer the lag in response, the greater will be the damage to the economy and to the spirit of cooperative federalism.