The flip side of ‘one nation, one tax’

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India is the only large country in the world that is experiencing subnational income divergence

“A historic day for all of us" is how Union finance minister Arun Jaitley described the passage of the goods and services tax (GST) Bill in the Lok Sabha on 29 March. “One nation, one tax" is the Union government’s slogan for GST. The implication is that uniform tax rates across all states of India will serve as a unifying force of efficiency. Replacing several hundreds of different tax rates across the 29 states of India with just five tax slabs for all goods and services will reduce friction in the movement of goods and services across state borders. This can boost economic activity and contribute substantially to gross domestic product (GDP) growth. For these reasons, the GST initiative has been justifiably acclaimed as a milestone economic reform in independent India. But there are reasons to be cautious.

GST aims to forge an economic union of India at a time when the economic disparity among the various states of India is at its peak. For the sake of “one nation, one tax", states have sacrificed their fiscal rights. Such economic disparity combined with India’s unique political diversity renders the GST regime vulnerable to fractious demands.

India is currently experiencing a 3-3-3 paradox—the three richest states are three times richer than the three poorest states. This level of regional inequality is the highest in independent India’s history. Four states (Gujarat, Maharashtra, Tamil Nadu and Karnataka) account for as much inter-state trade as the other 25 states combined. One-fifth of all passenger cars and two-wheelers are sold in just two states—Maharashtra and Tamil Nadu. The average Tamilian earns Rs1.4 lakh per year, four times more than the average Bihari’s annual income of Rs35,000. What is worse is that India is the only large country in the world that is experiencing subnational income divergence, i.e. the income gap between the richer and poorer states continues to widen and not shrink. The average Tamilian is 31 years old and a matriculate while the average Bihari is 19 and a primary-school dropout.

It is then evident that the policy priorities and taxation structure need to be different for these two states, in line with their economic and demographic differences. A smartphone may be considered a luxury product in Bihar but perhaps a necessity in Tamil Nadu. The GST council which gives equal representation to all states will attempt to strike a balance between such pulls and pressures. The future of GST hangs on this delicate balance, especially when inter-state economic disparity continues to widen. Recent research (see Mint, 8 February 2017: **Will GST Exacerbate India's Income Divergence?** by Praveen Chakravarty and Vivek Dehejia) has shown that GST can potentially exacerbate regional inequality. What complicates this further in the Indian context is its unique nature of political diversity.

In 1982, the then chief minister of Tamil Nadu, M.G. Ramachandran (MGR), was able to fulfil his election promise of a midday meal scheme for all schoolchildren only by increasing taxes on all goods sold in the state. The scheme was a big success and Tamil Nadu's literacy rate rose from 51% to 83% in two decades. Under a GST regime, such a one-time state-specific tax increase is not possible. This restricts the abilities of regional political parties to govern the state in accordance with the needs of the people of that state alone.

Nearly two-fifths of India's GDP and one-third of the population are governed by regional political parties that have no electoral presence outside their specific states. Even after the Bharatiya Janata Party's (BJP's) recent landslide victory in Uttar Pradesh, more than 50 regional parties have as many legislators in state assemblies across India as do the two national parties. Under GST, regional political parties will, for the first time, continue to have full political powers to govern their states bereft of full fiscal powers of taxation. Unlike national parties with a high-command culture, regional parties cannot easily be coerced into a "national" narrative at the risk of alienating their specific voter base. It will be a big challenge to balance the interests of a diverse set of states represented by a diverse set of political parties in the larger "national" interest on a sustained basis. Dispersed political power and stark economic disparity across states are bound to render the idea of a "one nation, one tax" even more challenging in India than in other federal economies. To be clear, this is not a criticism of GST but a plea to heed the intangible costs of GST that need to be carefully and constantly evaluated and contained. The economics of a “one nation, one tax" GST regime may be exciting to corporate India but the political economy of it can be daunting.

“One nation, one tax", “One nation, one language", “One nation, one election", “One nation, one curriculum"—a “one nation" construct seems to be the cornerstone of many of the policy initiatives of the Union government, ironically headed by a prime minister who was once a staunch defender of India’s federalism as a chief minister of a state. Efficiency gains through standardization are often touted as the motivation for these policies. Such efficiency tugs at the heart of true federalism by implicitly demanding oneness.

In the 67 years since India became a republic, its states have diverged dramatically from each other in demographic, economic, social and political parameters. The big gamble of GST is that the economic benefits to the nation as a whole will trump the fissiparous predilections of India’s political union. Amid the jubilation over a newly forged tax union, it is perhaps appropriate to recall the warning of one of India’s tallest statesmen, C. Rajagopalachari, in the early years of the republic—“you cannot achieve unity of this country by imposing uniformity."

Praveen Chakravarty and Palanivel Thiagarajan are, respectively, senior fellow at the IDFC Institute and Dravida Munnetra Kazhagam (DMK) member of the Tamil Nadu legislative assembly.