Fuel for development

Revenue from Centre's taxes on petroleum products goes to states, welfare programmes.

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The effect of increasing petroleum prices on the tax collected by the Centre and the states needs to be understood clearly.

There has been lot of hue and cry over the rising prices of petroleum products in recent months, but it seems that the central government is not going to oblige. The statement by former Finance Minister P Chidambaram, that the prices of petrol and diesel could be reduced was rejected by Arun Jaitley. The Centre has some compelling reasons not to tinker with the prices of petroleum products.

The pricing of petroleum products is always a contentious issue. On the one hand, it has a large impact on domestic inflation and on the other, it is a major source of revenue for the exchequer. The dependence on imports — over 80 per cent of our consumption needs — undermines our capacity to determine its prices. A one-dollar increase in the international price of crude oil increases the cost of petrol and diesel in India by Rs 0.50/litre and a fall in the exchange rate of the rupee against the US dollar increase the cost of petrol and diesel in India by Rs 0.65/litre. Thus, for all practical purposes the price of petroleum products are exogenously determined.

During UPA rule, under Administered Price Mechanism (APM), petrol and diesel prices were not market-linked and the steep increase in international prices used to exert severe pressure on the oil marketing companies (OMC). The retail prices were kept below the cost, resulting in large under-recoveries for OMCs. From the year 2004-05 to 2013-14, the total under-recoveries was Rs 8,53,628 crore.

During 2004-08, when international crude prices were rising rapidly, the government subsidy on petroleum products proved grossly insufficient. Since the fiscal position of the government was already precarious, it could not increase the subsidy. The government resorted to issuing “oil bonds” to the OMCs in place of cash subsidy. These interest-bearing bonds were not even reflected on the balance sheet by the UPA government, resulting in the artificial measurement of the burgeoning fiscal deficit. Between 2005-06 and 2009-10, oil bonds worth Rs 1,42,202 crore were issued by the government interest on them ranging from 7.33 per cent to 8.4 per cent, per annum repayable up to 2024-25 by successive governments.

This worsening fiscal situation under UPA led to the hardening of the interest rates affecting borrowing and investment for the corporate sector and runaway inflation for the common people. Thus, while the people where getting petrol and diesel at comparatively lower prices, they were paying much higher prices for almost everything else. The burden-sharing mechanism devised by the UPA government had also led to a depletion of cash reserves of upstream oil companies like ONGC, GAIL and OIL and the destruction of their intrinsic value.

This brings us to the argument that petroleum products are highly taxed in India and they need to be brought down to control the spiralling prices. The contribution to central and state exchequer by the petroleum sector in the last few years is as follows: The Centre received Rs 1,26,025 crore, Rs 2,09,354 crore, and Rs 2,73,225 crore in 2014-15, 2015-16 and 2016-7 respectively, and an estimated Rs 2,84,442 crore in 2017-18. While the states received Rs 1,60,526, Rs 1,60,114, Rs 1,89,587 and Rs 2,08,893 in the same years.

India needs this revenue for catalysing economic growth, building infrastructure for better quality of life and providing social security to the poor and in backward areas. Second, a large component of central government duties on petroleum products — 42 per cent of the basic excise duty — is given to state governments. Also, 60 per cent of the remaining 58 per cent of the basic excise duty collection is spent on centrally-sponsored welfare schemes in the states. Thus, the total amount transferred to the states is (42+34.8)= 76.8 per cent. It is estimated that a Rs 1 reduction in the excise duty would reduce revenue collection by Rs 14,000 crore.

The effect of increasing petroleum prices on the tax collected by the Centre and the states needs to be understood clearly. In the decontrolled regime that India is currently following, any change in international crude price is passed on to the consumer. Higher prices are likely to reduce consumption. The taxes imposed by the Centre are specific — fixed in terms of Rs per unit. So, if the consumption falls, the tax collected by the Centre also goes down. The states, however, levy ad valorem tax and it is likely that with the increase in petroleum prices, its tax collection goes up even with falling consumption. Therefore, if there is any merit in the argument that the taxes on petroleum products should be reduced in wake of the increasing international prices, it applies more forcefully to the states than to the Centre.

Ultimately, the long-term solution to this teething problem is to change the share of petroleum products in energy consumption mix (34.48 per cent in 2015-16). We need to generate more energy from coal and lignite (46.28 per cent), which we have in abundance and also focus on electricity generation from hydro, nuclear and other renewable sources like wind and solar (12.75 per cent). The Narendra Modigovernment is working on this long-term solution and in the coming years we will see a fall in the contribution of petroleum products in the source-wise energy share.

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