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Issue Brief

High Fuel Prices: Does the End Justify the Means?

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Summary

The contentious discourse in the media has primarily laid the blame for rising fuel prices on high central taxes. The debate ignores the implications of state taxes on fuel prices. The quantum of amount collected on account of such high taxes in the recent past and its utilisation have not been brought to focus. The financial implications of the lowering of the tax rates on the government finances (both the central and the state governments) and its impact on the government projects/schemes also needs to be taken into account.

Over the last few days, the issue of high fuel prices, despite the reduction in international crude prices over the past three years, has been a contentious subject of discussion. Data regarding international crude prices, price per litre of diesel and petrol in some of our neighbouring countries, as also the absolute amount of taxes (both central and state), dealers' margins per litre of fuel in each state and the percentage component of these elements are available. What has been missing in the discussions is how has the government used the additional resources that have been generated as a result of the high fuel prices?

Price comparison with other countries

All countries have access to the same petroleum prices of international markets but then decide to impose different taxes. The differences in prices across countries are due to the various taxes and subsidies for diesel (Diesel is chosen as an example here because it is the highest consumed petroleum product). As a result, the retail price of diesel is different. The average price of diesel around the world on 18 September 2017 was $0.96 per litre. However, there is a substantial difference in these prices among countries. As a general rule, the richer countries have higher prices while the poorer countries and the countries that produce and export oil have significantly lower prices.

Table No. 1

Price per Litre of Diesel in USD on 18 September2017

Country		Country	Per litre
Russia	0.64	Myanmar	0.53
USA	0.72	Afghanistan	0.66
China	0.89	Sri Lanka	0.62
India	0.95	Nepal	0.72
South Africa	1	Pakistan	0.73
Brazil	1	Bangladesh	0.79
South Korea	1.13	Namibia	0.80
Germany	1.37	Cambodia	0.81
France	1.47	Uganda	0.83
Israel	1.62	Bhutan	0.87
UK	1.63	Ghana	0.91

Source: http://www.globalpetrolprices.com/diesel_prices/ accessed on 21 September 2017

The above table tells us that rates in India are around the average world price.

Trends in international petroleum prices in the recent past

The price trends of crude and three major consumption petroleum products based on indices hosted on the website of the Economic Advisor, Department of Industrial promotion (DIPP), are tabulated in Table No 2. The data indicates that the prices fell through in 2014-15 and the price fall gathered momentum in 2015-16. The prices were nearly stable through 2016-17 and began to rise in April 2017-18, remained nearly stable in May to July, but began to rise in August and the rise has continued in September.

Table No. 2: Price indices of petroleum products

Price change over previous financial year								
	Crude		HSD		Petrol		ATF	
FY	**Index**	Change over previous year	**Index**	Change over previous year	**Index**	Change over previous year	**Index**	Change over previous year
16-17	63.8	4.55	74.4	1.34	72.4	-4.56	69.3	-0.29
15-16	60.9	-56.32	73.4	-56.40	75.7	-43.46	69.5	-51.22
14-15	95.2	-23.00	115	-10.02	109	-14.73	105	-13.89
13-14	117	7.43	126	11.64	125	7.78	120	5.93
12-13	108		112		115		113	
Price change in 2016-17 over previous month (Except in the month of April the price change is over average of the previous year								
Aug	55.6	1.08	80.6	2.23	76.6	3.13	69.3	1.73
July	55	0.00	78.8	-1.52	74.2	-3.50	68.1	-4.85
June	55	-12.18	80	-1.63	76.8	-1.17	71.4	-4.76
May	61.7	-3.40	81.3	-0.25	77.7	-0.77	74.8	0.13
April	63.8	0.00	81.5	8.71	78.3	7.54	74.7	7.23
16-17	63.8		74.4		72.4		69.3	

Source: Economic Advisor DIPP http://eaindustry.nic.in/home.asp

Why public outcry in September 2017

Petrol prices were made 'market-determined' effective 26 June 2010. With diesel remaining subsidised, the gap in the price between petrol and diesel began to widen. It rose to Rs 27.14 per litre in 2012 which resulted in the dieselisation of private vehicle ownership and SUVs began to be seen in larger numbers as well. The diesel price was made market-determined only effective 19 October 2014. The last notified price of diesel at the pre-market determined date was Rs 58.97 on 31 August 2014 and from 19 October 2014, it became Rs 55.6. Thereafter it continued to fall reflecting global trends and was in the range of Rs 40 to Rs 50 till April 2016. This was a welcome step, which though was feared for political reasons, as the withdrawal of subsidy would increase diesel prices, and lead to a rise in the already high inflation rates.

The prices were revised every 15 days and after breaching Rs 50 mark in May 2016, they rose to Rs 59 in January 2017 to again fell gradually and the price on 01 June was Rs 55.94.[1] The government launched a 'pilot project' in five cities from 01 May 2017 to do a daily review of petrol and diesel prices (a norm in most countries). Beginning 16 June 2017, the state oil companies throughout the country began daily revision of petrol and diesel prices.

The crude oil prices began to harden immediately after Hurricane 'Irma'. After 'Irma' dissipated, a human hurricane 'Kim Jong-un' is keeping the crude prices high. In Table No 3 below are tabulated the price in rupees of crude oil per barrel (Indian basket). One barrel is 159 litres.

Table No. 3: Price in rupees of Crude Oil per barrel (Indian Basket)

Date		Date		Date		Date	
31/08/17	3221.33	06/09/17	3401.13	12/09/17	3392.90	19/09/17	3514.18
01/09/17	3219.57	07/09/17	3418.64	13/09/17	3443.89	20/09/17	3535.42
04/09/17	3288.10	08/09/17	3424.94	14/09/17	3495.38	21/09/17	3581.88
05/09/17	3330.58	11/09/17	3368.39	18/09/17	3502.08		

Source: Ministry of Petroleum notification through PIB http://pib.nic.in/newsite/PrintRelease.aspx?relid=171011

[1] Prices quoted are for Delhi. Seehttps://www.iocl.com/Product_PreviousPrice/DieselPreviousPrice.aspx

This resulted in upward revision of retail prices on nearly daily basis and the last straw on the camel's back was the release of GDP data for the first quarter and the inflation data, which resulted in the chorus for reduction of fuel prices getting louder.

Components of retail fuel price

The price breakdown of the retail price into various components in percentage terms is given in table below.

Table No 4: Retail price breakdown in percentage terms in Mumbai and Delhi

	Mumbai		Delhi	
	Petrol	Diesel	Petrol	Diesel
Price before taxation and dealer commission	40.5	49.7	42.87*	51.03*
			*Break down	
Crude Oil - Cost per Litre			29.31	35.38
Oil marketing Company's cost includes: Entry Tax, Refinery Processing, Landing Cost & Other Operational Costs along with Margins + OMC Margin, Transportation, Freight cost			13.56	15.65
Total Central Taxes (Excise duty)	34.3	32.5	31.18	30.37
Total State taxes	21.3	14.8	21.25	14.79
Dealers commission	4	3	4.69	3.8
	100.1	100	100	00
Source: Mumbai prices: Epaper, Indian Express, New Delhi Edition, Sep 15, 2017. Delhi Prices http://www.mycarhelpline.com/index.php?option=com_latestnews&view=detail&n_id=417&Itemid=10				

There was no excise duty on diesel and petrol when these were being subsidised. The central government took advantage of the falling crude prices while passing on the benefit to the consumers because of 'market-determined pricing' and also used the opportunity to generate additional resources. The excise duty rates post diesel 'market-determined' prices, i.e. October 2014 are:

Table No 5: Rise of excise duty, per Litre

	Petrol	Diesel
Rate prior to Nov 2014	9.48	3.56

12 Nov 2014	10.7	4.96
02 Dec 2014	12.95	5.96
02 Jan 2015	14.95	7.96
16 Jan 2015	17.46	10.26
07 Nov 2015	19.06	10.66
Post Jan 2016	21.48	17.33

The states too were not far behind. For instance, the VAT on Petrol & Diesel in Delhi, which was 20 per cent and 12.5 per cent respectively of base price prior to November 2014, is now 27 per cent and 16.75 per cent + 25 paisa cess, respectively. While state taxes vary, the central government excise collection on account of petrol and diesel in rupees in crores is as shown in table below:

Table No. 6

	2013-14	2014-15	2015-16	2016-17 (upto February)
Petrol	22424	30826	53413	64509
Diesel	27146	42464	101177	137426
Source: Lok Sabha, Unstarred Question No.4955 replied on 31 Mar 2017				

Where have the additional resources been spent?

Interest, Subsidies and Defence Expenditure are the three major components of the central government Expenditure.[2] The details of expenditure under these heads is given below:

Table No 7: Total expenditure under three major heads

	10-11	11-12	12-13	13-14	14-15	15-16	16-17
Interest	234022	273150	313170	374254	402444	441659	480519
Subsidies	177747	217903	257174	254745	258299	258471	232705
Defence Expenditure	154115	170913	181776	203672	218694	226031	247837

[2] RBI Handbook of Statistics on Indian Economy, Table 102: Major Heads of Expenditure of the Central Government

Total	565884	661966	752120	832671	879437	926161	961061
Defence expenditure increase over previous year		10.90	6.36	12.05	7.38	3.35	9.65

Despite the rising public debt, the government has been able to manage to moderate the interest burden through retiring high cost debt and take advantage of the economy moving towards a more benign interest rate cycle. The food subsidy which was Rs 85000 Crores in 2012-13 has risen to Rs 139419 crores and the BE for 2017-18 is Rs 145339 crores. Yet the total subsidy in 2016-17 due to the containment of fuel subsidy through 'market-determined' pricing approach (for impact see Table No 8 below) and an innovative fertilizer policy initiative is less than what it was in 2012-13. As may be seen in the table above, the rise in defence expenditure has been very modest in the last three years. The capital expenditure BE sanctioned from 2012-13 onwards till 2016-17 has been revised down substantially at RE stage adversely impacting the modernisation process.[3] The withdrawal of customs exemption and excise duty on sales from DPSUs to defence forces in the last year has put additional strain on the already meagre defence budget and in the current year, the rising fuel prices will impact the training effort. So the government has been conservative in its expenditure. If that were the case, where has the additional revenue been utilised?

[3]For details, please see http://www.idsa.in/system/files/jds/jds_11_1_2017_indian-defence-budget.pdf

Table No. 8: Under recoveries/ DBTL Subsidy on Sale of Sensitive Petroleum Products

Period: 2005-06 to Q1 2017-18 (April-June) (Rs. Crore)

Fin Year	Petrol	Diesel	Domestic LPG (Subsidised)^	DBTL Subsidy on Domestic LPG (Subsidised)^	PMUY Subsidy on Domestic LPG	DBTK Subsidy on PDS Kerosene	PDS Kerosene	Total
05-06	2723	12647	10246				14384	**40000**
06-07	2027	18776	10701				17883	**49387**
07-08	7332	35166	15523				19102	**77123**
08-09	5181	52286	17600				28225	**103292**
09-10	5151	9279	14257				17364	**46051**
10-11**	2227	34706	21772				19484	**78190**
11-12		81192	29997				27352	**138541**
12-13		92061	39558				29410	**161029**
13-14		62837	46458	3869			30574	**143738**
14-15 #		10935	36580	3971			24799	**76285**
15-16			18	16056			11496	**27570**
16-17				12133	2999	11	7595	**22738**
Q1 17-18				5039	736	14	1280	**7069**

** Under recovery on Petrol is only up to 25th June'2010. # Under recovery on Diesel is only up to 18th October '2014. ^Government has taken decision to restrict the supply of subsidized LPG cylinders to each consumer to 12 cylinders annually.

Source: https://www.google.co.in/search?q=diesel+subsidy+18+Oct+2014&ie=utf-8&oe=utf-8&client=firefox-b&gfe_rd=cr&dcr=0&ei=vlXEWZn-K5Ly8AfDzqjABQ

States share of the revenue

The 14th Finance Commission examined the issue keeping in mind three factors: (a) the spirit of constitutional provisions; (b) the concerns about fiscal space expressed by States and Union; and (c) the need for clarity on the respective functional and expenditure responsibilities of Union and States in the interest of sound federal fiscal relations. They were of the view that 'tax devolution should be the primary route of transfer of resources to States since it is formula-based and thus conducive to sound fiscal federalism. However, to the extent that formula-based transfers do not meet the needs of specific States, they need to be supplemented by grants-in-aid on an assured basis and in a fair manner'. In their report they recommended that 'tax devolution to 42 per cent of the divisible pool would serve the twin objectives of increasing the flow of unconditional transfers to the States and yet leave appropriate fiscal space for the Union to carry out specific purpose transfers to the States'. The report of the commission was submitted in December 2014. The result of this may be seen in the Table below:

Table No 9: Tax revenue of the Central govt. and states share

	Actual 2013-14	Actual 2014-15	% Increase over previous year	Actual 2015-16	% Increase over previous year	Actual 2016-17(Provisional	% Increase over previous year
Corporation Tax	394678	428925	8.68	453229	5.67	484924	6.99
Taxes on Income	237817	265733	11.74	287636	8.24	340592	18.41
Wealth Tax etc.	6047	1085		1079		29945	
Customs	172085	188016	9.26	210338	11.87	225961	7.43
Union Excise Duties	169455	189953	12.10	288074	51.66	381141	32.31
Service Tax	154778	167969	8.52	211414	25.86	254608	20.43
Taxes of Union Territories	3874	3204		3878			
Less- NCCD Transferred to the National Calamity Contingency Fund/ National Disaster Response Fund	4650	3461		5690		7109	
Less- States' share	318230	337809	6.15	506193	49.85	608000	20.11
Centre's Net Tax Revenue	815854	903615	10.76	943765	4.44	1102063	16.77
State Share Ratio of the total tax revenue	28.06	27.21		34.91		35.55	

Source: Data from Controller General of Accounts (CGA) web site

As can be seen from Table 9, Excise Duty has increased by about Rs. one lakh crore in 2015-16 and 2016-17. The major factor in this increase has been both direct and indirect contributions of the fall in crude prices and the government mopping up additional funds through revising the excise duty and the indirect contribution of lower fuel prices pushing the sales of the automobile industry. The states' share of central tax revenue grew by almost 50 per cent in 2015-16 and 20 per cent in 2016-

17. This being non-discretionary distribution based on percentage share of each state as recommended by the Finance Commission, the increase in the share of the states has substantially contributed to federal polity and spirit of co-operation. This has generated the goodwill and trust that the Central government will be able to stand by its promise to ensure compensation for loss of revenue, if any, due to GST implementation and has thus enabled the much needed economic reform of 'GST' finally being implemented and the rates being agreed by consensus.

The revenue growth has also been utilised for capital expenditure which has grown from Rs 192,000 crores in 2014-15 to a BE of Rs 309,000 crores in 2017-18 (as per the Medium-term Expenditure Framework Statement laid before Parliament on August 10, 2017). The major components of this are Railways (Rs. 55,000 crore), Road Transport & Highways (Rs. 54,177 crore), Urban Development (Rs. 19,332 crore) and Department of Financial Services (Rs. 14,718 crore) for re-capitalisation of banks.

Conclusion

The additional resources generated have been generously passed on to the states and the impetus to infrastructure improvement is visible. The GST roll out has had its share of expected teething problems and it will be some time before it settles down. Its impact on revenue collection for the year 2017-18 will be known after it settles down. The central government needs to ensure that states get their budgeted share of revenue, as they would have already committed these expected funds. The goodwill generated in federal relations needs to be carried forward. Funds committed for road, rail and urban infrastructure are much needed both for infrastructure up-gradation as well as their multiplier effect on the economy. This leaves no room for the government to yield to the demand for roll back of fuel prices at this stage. It needs to be alive to this demand to ensure that should the crude prices harden any further, it should find a mechanism in consultation with states to maintain them at the present level.

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