RATIONALISE THE EXCISE DUTY AND VAT ON PETROL AND DIESELTO BOOST ECONOMY

Global crude oil prices have been reasonably volatile in the last 2 years, falling from a high of USD 115/barrel in mid-2014 to a low of USD 28/ barrel in January 2016. In late December 2016, crude oil prices touched the highs of USD 55 / barrel, up 15% since the OPEC decision on production cut. This translated into increase in petrol and diesel prices. This is the fourth straight increase in prices of petrol and third straight increase in prices of diesel India since November-December 2016.

India imports 70-80% of its crude oil requirements and the continued upward movement in oil prices has an impact on domestic prices of petrol and diesel. With the rising oil prices, India's oil import bill for 2016-17 will be much above the estimated USD 66 bn worked at an average import price of USD 48 bbl. India's oil import bill was USD 64 bn in 2015-16, USD 113 bn in 2014-15 and USD 143 bn in 2013-14. High oil prices have a cascading effect on the entire economy and thereby triggers inflation.

In the recent past, the Centre and state governments have steadily increased excise duties and VAT, thereby meeting its short-fall revenue target and have kept fuel prices substantially high for retail consumers. Apart from excise and VAT, many State governments levy octroi and additional surcharge / cess. The table below provides details of various taxes and the resultant % increase in total taxes in last 3 years. Today, state taxes are highest in Maharashtra.

	Tax in November 2014	**Tax in January 1, 2017**	**% increase**
Excise Duty on Petrol	Rs 9.20 per Litre	Rs 21.48 per Litre	~ 235%
Excise Duty on Diesel	Rs 3.46 per Litre	Rs 17.33 per Litre	~500%
VAT on Basic Price on Petrol	20% on Basic Price	27% on Basic Price	~35%
VAT on Basic Price on Diesel	12.5% on Basic Price	16.75% on Diesel + 25p cess	~40% including cess

The lower petroleum price and corresponding higher tax collections (excise and VAT) in 2016 have helped to significantly improve India's macro-economic fundamentals such as inflation, fiscal deficit and current account deficit.

Current Account Deficit

Fall in crude oil prices have helped the country save on import bill, thereby narrowing its current account deficit (CAD). CAD lowered to 0.6%of GDP in Q2 FY2016-17. Lower CAD, coupled with strong foreign capital inflows have helped India build up its forex reserves, which, in turn, has reduced its external vulnerability. The currency also has benefited from lower CAD on the back of reduced demand for dollars required to fund the deficit. INR was one of the best performing emerging market currencies in 2015 - 16.

Inflation

A rise in oil price leads to an increase in prices of all goods and services and thereafter inflation rises. High inflation affects companies - directly because of a rise in input costs and indirectly through a fall in consumer demand. Inflation in the fuel and light component of CPI accelerated significantly to 3.77% in December 2016, from 2.80% in the preceding two months. The rise in the fuel prices could exert upward pressure on generalized inflation in the coming months as fuel is a universal intermediate. This can prevent Reserve Bank of India from reducing policy rates in the coming days.

Rising interest rates

Lending rates in India depend on the inflation. Today, one time extra-ordinary event such as demonetisation has helped banks to infuse liquidity in the market. However, the steady increase in oil prices will impact inflation negatively. Fuel and power prices have a 15 per cent weightage in Wholesale Price Index (WPI)-based inflation. Any surge in WPI inflation will further dissuade RBI to cut rates in short to medium terms, thereby impacting the liquidity in the market.

Oil subsidy and fiscal deficit

As the government compensates oil PSUs under recoveries, these losses / under-recoveries adds to the government's total expenditure and leads to a rise in fiscal deficit The fall in oil prices have reduced PSU oil companies' losses, oil subsidies and thus have helped narrow fiscal deficit.

Trade deficit

In April 2016, India's trade deficit stood at USD 4.8 billion, almost 50 per cent lower than the USD 10.9 billion a year ago. Much of this huge slump was due to falling oil prices.

Today, many global events are leading to an increasing situation of higher oil prices in the short term. OPEC and non-OPEC countries have agreed to their production cut since 2008. Further, Mr. Donald Trump, President-elect, US have announced an aggressive growth plan. IMF has revised its growth rate to 3.4% from earlier 3.1% indicating higher demand in the medium term.

Lower inflation, interest rates, and stable CAD has helped the Government to keep economy on track for last 12-18 months. Government must realign its taxes particularly the excise and state VAT to rationalize consumer oil prices to reasonable and acceptable levels. It is likely that petrol and diesel would be excluded from the proposed GST regime in the first two years of the regime. Therefore, the industries that use petrol and diesel as raw materials may not be able to claim input tax credit for the excise duty and VAT paid on these two products, while they may still have to pay the applicable GST rate on the final output. This would adversely affect the margins of these industries. Therefore, the government must consider rationalizing excise duty on petrol and diesel immediately.

Government must also look at aggressively pushing tax reforms including corporate tax simplification and GST implication along with speeding up the disinvestment to meet its revenue target instead of targeting the crude oil. The additional generated liquidity will boost retail, consumer goods and auto sectors and revitalize the purchasing power of consumers which will help push economy and translate into higher GDP.