Ecowrap

BRINGING PETROL AND DIESEL UNDER GST LIMITS PAN INDIA PETROL PRICES AT RS 75 & DIESEL AT RS 68 : APPROX REVENUE LOSS FOR CENTRE & STATES ONLY AT 0.4% OF GDP/RS 1 LAKH CRORE: FISCAL DEFICIT FOR CURRENT FISCAL WILL BE LOWER

yono SBI
'Be the Bank of Choice for a Transforming India'
Issue No. 79, FY21
Date: 04 March 2021

One of the unfinished agendas of the current GST regime is bringing petrol and diesel under GST. Centre & States are loathe to bring crude oil products under the GST regime as Sales Tax/VAT on petroleum products is a major source of own tax revenue for them. Thus, there is lack of political will to bring crude under the ambit of GST. Interestingly, no country in the world has a completely transparent mechanism in pricing petroleum products. However, the federal nature of taxing makes estimating state-wise POL related product prices an especially tough exercise for India.

Every state has its own tax structure. The states choose to levy a combination of ad valorem tax, cess, extra VAT/Surcharge based on their needs. These taxes are imposed after taking into account the crude price, the transportation charge, the dealer commission and the flat excise duty imposed by the centre. The multiple taxes have made POL product prices one of the highest in the world.

We recommend the following tax structure for petrol and diesel if Government includes petrol and diesel in GST regime also. Our base estimate is based on following assumptions:

- Crude price at $60/bbl,
- Rupee dollar exchange rate at Rs 73
- Transportation changes of Rs 7.25 for diesel and Rs 3.82 for petrol,
- Dealer commission of Rs 2.53 for diesel and Rs 3.67 for petrol,
- Cess of Rs 30 for petrol and Rs 20 for diesel, with equal division between States and Centre (Rs 15 for states and Centre each for petrol and likewise for diesel at Rs 10) and finally
- GST rate at 28% (Centre: 14%, State: 14%)
- FY22 Petrol consumption growth rate : 10% y-o-y, Diesel Consumption growth rate : 15% y-o-y

Using all these assumptions we find that our base price for petrol and diesel comes out to be Rs 75 and Rs 68 per litre, respectively at pan India level. At this base price, with multiple simulations Centre & States have a revenue deviation from budget estimates by only Rs 1 lakh crore / 0.4% of GDP after adjusting for the increase in consumption with the intended price cut. A dollar increase in the crude oil prices will push up the petrol price by around 50 paise and diesel prices by around 150 paise and bring down the overall deviation by around Rs 1500 crore under our baseline scenario. When we use this tax structure for F22, when Centre and states taxes are already so high, we see that states which have the highest rates are losing revenue if they shift to this GST regime. But this flat taxation structure brings in uniformity and as per our calculations, it brings down the burden of taxes on the common man by almost Rs 10-30 depending on the product consumed and the state in which it is consumed. Additionally, it benefits some states which do not drastically tax their petroleum products, like Uttar Pradesh.

Interestingly, our simulation exercise suggests that when crude oil /bbl declines by $10, Centre & States could save close to Rs 18,000 crore, if they keep the petrol prices at baseline Rs 75 & diesel at Rs 68 and don't pass on the benefit to consumers. This is higher than the savings at Rs 9000 crores, when crude prices go up by$10/bbl and if in the same vein increased prices are not passed on. We thus recommend Government builds up an oil price stabilisation fund which can be used in bad times for compensating revenue loss by cross subsidising fund saved from good times, without hurting the consumer.

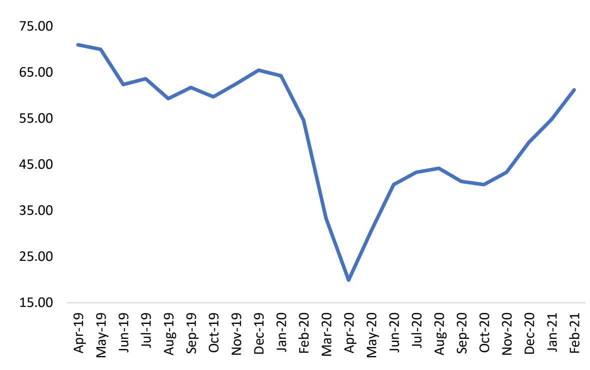
Separately, for the LPG cylinders, we propose an increased and graded subsidy may be provided to poor consumers which can be tapered off over a period of, say, 5-years. For this, the Government can create a comprehensive merged database using databases of Ayushman Bharat, PM-KISAN, PMJDY, PMUY and MUDRA and then provide these people with maximum four free cylinders in a year. Even if 5 crore people are eligible for this then the total cost to exchequer per year will be maximum Rs 16,000 crore (5 crore x 4 x Rs 800 per cylinder).

Meanwhile, some good news on fiscal front. The latest revenue and expenditure numbers could lead to lowering of fiscal deficit to 8.7% of GDP from 9.5% as per revised BE in FY21 budget. If this is so, it is highly likely that the Government might cancel its borrowing planned in the last 2 weeks of Mar'21, totalling Rs 49,000 crore. This in turn might lead to lowering of 10 year G-sec yield by end-March. And the better than expected revenue position could be a leverage for tax rationalisation on petroleum products too in the coming days!

CRUDE OIL PRICE MOVEMENT

- Brent crude oil spot prices averaged $55 per barrel (b) in Jan'21, up $5/b from the Dec'20 average but $9/b lower than the average in Jan'20. Higher Brent prices in Jan'20 largely reflected the January 5 announcement by Saudi Arabia that it would unilaterally cut 1.0 million barrels per day (b/d) of crude oil production in Feb-Mar'20, in addition to the reduced production levels on which the Organization of the Petroleum Exporting Countries (OPEC) and partner countries (OPEC+) previously agreed. The U.S. Energy Information Administration (EIA) expects Brent crude oil prices will average $56/b in the first quarter of 2021 and $52/b over the remainder of the year. EIA expects lower oil prices later in 2021 as a result of rising oil supply that will slow the pace of global oil inventory withdrawals. EIA also expects that high global oil inventory levels and spare production capacity will limit upward price pressures.

Crude oil price (Indian basket))$/bbl)



Source: SBI Research

- If we look at the 2020 figures, Brent crude oil spot prices averaged $42/b, as COVID-19 related demand slowdown adversely impacted oil prices. On the back of benign crude prices, Indian states had raised the VAT/Sales tax on crude products to support the state finances. If we look at the data which is available for 9M FY21, the Sales Tax/ VAT on POL Products has already contributed to Rs 1.35 lakh crores to State exchequer. For the entire FY20 this value was Rs 2.04 lakh crores.
- When we look at the consumption of POL products, 140638 thousand metric tonne of POL products were consumed in 9M FY21, vis-à-vis 161347 thousand metric tonnes in 9M FY20, a decline of 13%. The major components, MS (petrol) and HSD (diesel) saw a consumption decline of 12% and 17% respectively. The consumption decline combined with declining crude prices left states with no choice but to increase the taxes to shore up their revenue. As the crude oil price of Indian basket rose from $19 per barrel in Apr'20 to $61.22 per barrel in Feb'21, the taxes have started hurting the customers and there is a clamour to reduce the taxes.

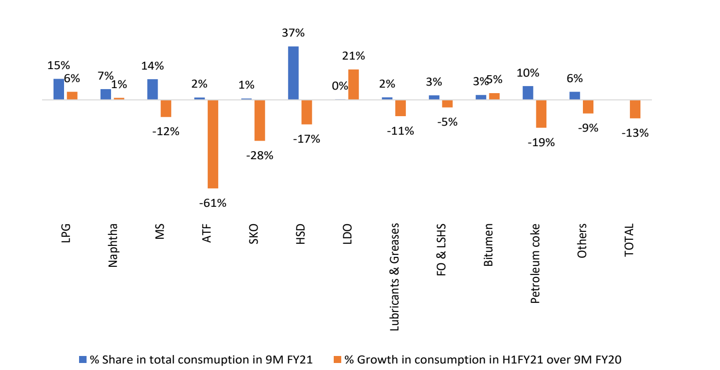
STATE OF STATE VAT/SALES TAX ON PETROL AND DIESEL

- The state wise contribution of Sales Tax/ VAT on POL Products data for 9M FY21 shows that Maharashtra, Uttar Pradesh and Tamil Nadu have been the largest recipients of State VAT/Sales Tax on POL products. Last year, too, these states had the highest share in the State VAT/Sales Tax collected. In the overall own tax revenue, the share of State VAT/Sales Tax on POL products has ranged from 0% for Meghalaya to 20% for Madhya Pradesh. **The average share is around 15% for all states in Own Tax Revenue.**

BRINGING PETROL AND DIESEL UNDER GST

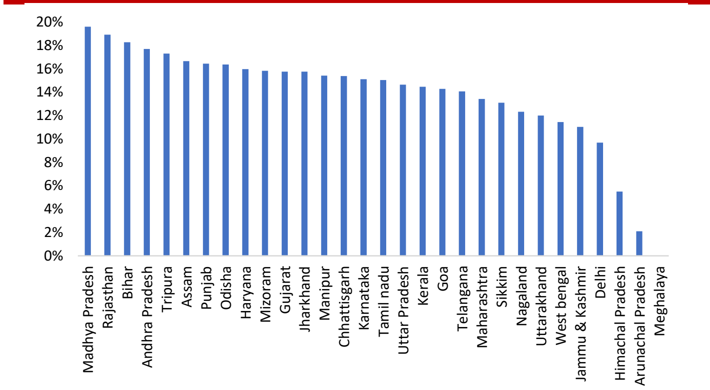
- Centre & States are loathe to bring crude oil products under the GST regime as Sales Tax/VAT on petroleum products is a major source of own tax revenue for them. Also, Centre gains both excise and customs on oil and oil products. Thus, there is lack of political will at both levels to bring Crude under the ambit of GST. No country in the world has a completely transparent mechanism in pricing petroleum products. However, the federal nature of taxing makes estimating state-wise POL related product prices an especially tough exercise for India.
- Every state has its own tax structure. The states choose to levy a combination of ad valorem tax, cess, extra VAT/Surcharge based on their needs. These taxes are imposed after taking into account the crude MRP, the transportation charge, the dealer commission and the flat excise duty imposed by the centre. The multiple taxes have made POL product prices one of the highest in the world.
- We estimate the petrol and diesel prices if Government includes petrol and diesel in GST regime also. Our **base estimate is** based on **following assumption**: (i) Crude price at $60/bbl, (ii) Rupee dollar exchange rate at Rs 73, (iii) transportation changes of Rs 7.25 for diesel and Rs 3.82 for petrol, (iv) dealer commission of Rs 2.53 for diesel and Rs 3.67 for petrol, (v) Cess of Rs 30 for petrol and Rs 20 for diesel, with equal division between states and Centre and finally (vi) GST rate at 28% (Centre: 14%, State: 14%).
- We have also assumed petrol consumption growth at 10% and diesel consumption growth at 15% for FY22 over FY21.

Consumption of POL Products



Source: SBI Research

% Share of Sales Tax/ VAT on POL products in Own Tax Revenue(FY20)



Source: SBI Research

- Using all these assumptions we find that **our base price for petrol and diesel comes out to be Rs 75 and Rs 68 per litre, respectively**. At this base price, Centre accrues revenue loss of Rs 1 lakh crore (or 0.5% of GDP) and states of Rs 30,000 crore, given our estimates of the state revenue under the current prevailing VAT regime. **However, some of this loss is offset by increase in consumption due to low prices (using the concept of price elasticity).**
- Various estimates indicate that **oil price elasticity** in India is around 0.3 (very low) given the fact that oil has no substitute. We have injected this fact in our analysis and calculated the increase in petrol and diesel consumption due to Re 1 change in petrol/diesel prices. We found out that Rs 1 decline in petrol/ diesel prices lead to increase in petrol plus diesel consumption by around 70 crore litres. Using this and given the current prices of petrol/diesel in Delhi the gain in revenues from increase in consumption due to new prices (Rs 75/Rs 68 for petrol/diesel) is in the range of Rs 35,000-Rs 50,000 crore (when crude per bbl is in the range of $50-60). **Hence the overall losses for Centre + States, which is in the range of Rs 1.30-1.50 lakh crore will come down to around Rs 1.0 lakh crore.**
- A dollar increase in the crude oil prices will push up the petrol price by around 50 paise and diesel prices by around 150 paise and bring down the overall deviation by around Rs 1500 crore under our baseline scenario.

Crude oil matrix and revenue deviation for FY22								
Crude oil price/bbl	Deviation from estimates (Rs crore)			Estimated Price (Rs Per litre)		Gross Centre & States Revenue Deviation as a % of GDP	Net Centre & States Revenue Deviation as a % of GDP	Increase in tax revenue due to increase in consumption (Rs crore)#
	Centre + States	Centre	States	Petrol	Diesel			
$75	-104454	-87227	-17,227	84	77	0.5%	0.4%	12056
$70	-113519	-91759	-21,759	81	74	0.5%	0.4%	19009
$65	-122584	-96292	-26,292	78	71	0.6%	0.4%	26018
$60	-131649	-100825	-30,825	75	68	0.6%	0.4%	34651
$50	-149779	-109890	-39,890	69	62	0.7%	0.4%	50208
$40	-167910	-118955	-48,955	63	56	0.8%	0.4%	73452
$30	-186040	-128020	-58,020	57	50	0.8%	0.4%	103045
$20	-204170	-137085	-67,085	51	44	0.9%	0.3%	134678
Memo:								
Revenue Estimates	600000	335000 BE	265000	-				

Source: SBI Research, CGST and SGST at 14% each, with a Rs 30 cess on petrol and a Rs 20 cess on diesel equally divided between Centre and States, ex rt: Rs 73/$; # Assuming oil price elasticity of 0.3

- When we use this tax structure for F22, when Centre and states taxes are already so high, we see that states which have the highest rates are losing revenue if they shift to this GST regime. (Refer Annexure) But this is natural given the excessive rates these states have imposed.
- But, this flat taxation structure brings in uniformity and as per our calculations, it brings down the burden of taxes on the common man by almost Rs 10-30 depending on the product consumed and the state in which it is consumed. Additionally, it benefits some states which do not drastically tax their petroleum products, like Uttar Pradesh.

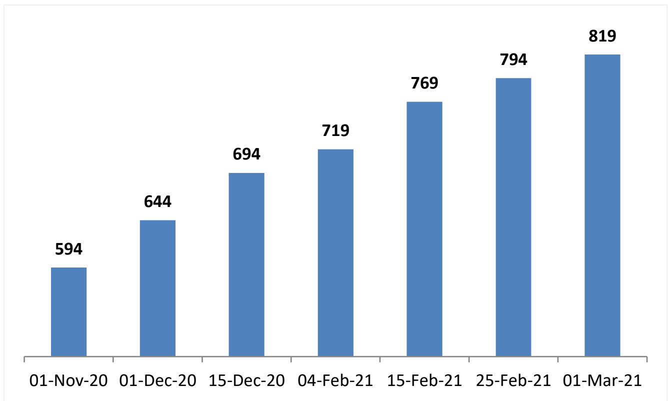
LPG PRICES HAVE ALSO INCREASED

- Since Nov-20, the prices of non-subsidized cylinder have increased from Rs 594 to Rs 819 (in Delhi), a substantial increase of Rs 225 per cylinder. The data on DBTL (Direct Benefit transfer for LPG) indicate that the subsidy amount has sharply plunged to merely Rs 3,363 crore in Apr-Dec'20 period (i.e. 374 crore per month) from Rs 22,635 in FY20 (i.e. 1,886 crore per month), which means that there is negligible or no difference between subsidized and non-subsidized cylinder.
- This throws concept of ability/willingness to pay in discussion. In the neoclassical approach to the consumer's utility maximization problem, consumer's willingness to pay is endogenous since it depends on his budget and preferences. There is no such concept as ability to pay in the neoclassical approach. A consumer's willingness to pay is the benefit of consumption and the maximum that a consumer wants to pay for the good when there are no borrowing constraints. A consumer who derives a high benefit from the consumption of a good may be willing to pay an expensive price even though his budget is limited or if he don't have any alternative. Ability to pay is a constraint that prevents the consumer to take decisions according to his willingness to pay.
- In the case of recent increase in LPG prices, the question arises that till what price consumers are willing to pay more?

UJJWALA 3.0: SOME TWEAKS REQUIRED

- Under the PMUY scheme, Government in 2018 has connected to 8 crore poor families through the free gas connections. To give a further boost, in the Budget 2021-22, Government has announced to give 1 crore more free LPG connections to the needy over the next 2-years and make it easier to access cooking gas to achieve near 100% penetration of the clean fuel in the country.

Price of Non-Subsidized Cylinder in Delhi (in Rs)



Source: SBI Research

- Though, PMUY has solved the problem of availability the affordability barrier still exists. Government should now focus on the 'affordability' issue and to achieve this, we suggest a set of measures as follows:
- * The current loan scheme under PMUY allows households the option to take hot plate on purchase of first refill or both on loan basis from zero interest rate and the same is recovered through subsidy received by the beneficiary. **This should be phased out and will only involve a one-time cost of around Rs 1500 crore and will improve the cost of refilling.**
- * An **increased and graded subsidy may be provided to PMUY and poor consumers which can be tapered off over a period of, say, 5-years**. For this, the Government can create a comprehensive merged database using databases of Ayushman Bharat, PM-KISAN, PMJDY, PMUY and MUDRA and then provide these people with maximum four free cylinders in a year. Even if 5 crore people are eligible for this then the total cost to exchequer per year will be maximum Rs 16,000 crore (5 crore x 4 x Rs 800 per cylinder). **We can also have a compulsory opt-in scheme for availing subsidies emulating nudge theory in policy making**.
- * The number of subsidised cylinders per annum to households can be reduced from the current 12 to 9 (average all India consumption is around 7 cylinders) which would be sufficient for most households. Introducing mandatory standards and labelling for LPG stoves will save at least 10/12% of the LPG consumption in the country.

GOVERNMENT FISCAL POSITION SHOWS LOWER NEED OF MARKET BORROWING: IN FY21: POSITIVE FOR YIELD

- As per the latest CGA data, the Government's fiscal deficit reached Rs 12.34 lakh crore at end-Jan'21 or 66.8% of the revised estimates for FY21.
- Expenditure data shows that the Government has already spent Rs 25.17 lakh crore as against Rs 34.50 lakh crore as per the revised budget estimates (73%), with capital expenditure already reaching 83% of the revised budget estimates of Rs 4.38 lakh crore. So the Government still has to spend a total of Rs 0.76 lakh crore in capital expenditure in the remaining 2 months of Feb-March. In addition, Rs 1.73 lakh crore of interest payments are due, Rs 3.43 lakh crore of subsidy payments including a chunk of Rs 2.97 lakh crore in food subsidy and Rs 0.12 lakh crore thus making a total of Rs 5.90 lakh crore in these heads still remaining to be spent in Feb-Mar'21.
- On the revenue side, higher tax receipts, particularly indirect taxes including excise duty has enabled the Government to collect Rs 12.42 lakh crore in net tax revenue so far till Jan'21, which is 79.9% of the revised BE for FY21, as against 66.3% of BE achieved last year during the same period. Thus, higher tax collections would enable the Government to have a surplus of Rs around 1 lakh crore. Furthermore, the Government has surplus cash balance of Rs 2.34 lakh crore currently and after adjusting for states share, the Government would be left with around Rs 0.5 lakh crore as surplus cash balance by Mar'21.
- This in turn could lead to lowering of fiscal deficit by around 0.8% of GDP to 8.7% of GDP from 9.5% as per RE. And if we also exclude the off balance sheet items it would come around 7.9% of GDP compared to 8.7% earlier.
- Furthermore, it would lead to lower need of Government borrowing this year. The Government has so far borrowed Rs 12.8 lakh crore against dated securities till 26 Feb'21. As per the calendar, Rs 1.04 lakh crore more will be borrowed in the remaining months leading to a total of Rs 13.84 lakh crore market borrowing this year. However, given that RBI had already done OMO of Rs 3 lakh crore so far this year, it is highly likely that the Government might cancel its borrowing planned in the last 2 weeks of Mar'21, totalling Rs 49,000 crore. This in turn might lead to lowering of 10 year G-sec yield by end-March.

Government Fiscal Maths (Rs lakh crore)

Major Heads	Actual Till Jan	Revised BE	Remaining for 2 months	Run Rate for Feb-March
Total expenditure	**25.2**	**34.5**	**9.3**	**4.7**
Revenue expenditure	21.6	30.1	8.6	4.3
Interest payment	5.2	6.9	1.7	0.9
Capital expenditure	3.6	4.4	0.8	0.4
Total subsidy	2.5	6.0	3.4	1.7
Nutrient based Fertiliser	0.3	0.4	0.1	0.1
Urea subsidy	0.7	0.9	0.2	0.1
Food subsidy	1.3	4.2	3.0	1.5
Total Receipts	**12.8**	**16.0**	**3.2**	**1.6**
Revenue Receipts	12.4	15.6	3.1	1.6
Tax Revenue	11.0	13.4	2.4	1.2
Memo:				
New Fiscal Deficit (Rs lakh crore)				17.0
Savings in Fiscal Deficit (Rs lakh crore)				1.5
New Fiscal Deficit (% of GDP)				8.7%
Fiscal deficit excluding off balance sheet (% of GDP)				7.9%
Source: SBI Research, CGA				

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ANNEXURE

State/UT	Current rate of State taxes: Petrol (Sales Tax/VAT)	Current rate of State taxes: Diesel (Sales Tax/VAT)	Estimated Gap in revenue between our suggested GST regime and the existing VAT structure (Rs crore)*
Maharashtra (Mumbai, Thane & Navi Mumbai)	26% VAT+ Rs.10.12/Litre additional tax	24% VAT+ Rs.3.00/Litre additional tax	-10424
Maharashtra	25% VAT+ Rs.10.12/Litre additional tax	21% VAT+ Rs.3.00/Litre additional tax	
Rajasthan	36% VAT+Rs 1500/KL road development cess	26% VAT+ Rs.1750/KL road development cess	-6388
Madhya Pradesh	33 % VAT + Rs.4.5/litre VAT+1%Cess	23% VAT+ Rs.3/litre VAT+1% Cess	-5489
Tamil Nadu	15% + Rs.13.02 per litre	11% + Rs.9.62 per litre	-4915
Andhra Pradesh	31% VAT + Rs.4/litre VAT+Rs.1/litre Road Development Cess and Vat thereon	22.25% VAT + Rs.4/litre VAT+Rs.1/litre Road Development Cess and Vat thereon	-4856
Karnataka	35% sales tax	24% sales tax	-3696
Telangana	35.20% VAT	27% VAT	-3026
Odisha	32% VAT	28% VAT	-2060
Kerala	30.08% sales tax+ Rs.1/litre additional sales tax + 1% cess	22.76% sales tax+ Rs.1/litre additional sales tax + 1% cess	-1721
Assam	32.66% or Rs.22.63 per litre whichever is higher as VAT	23.66% or Rs.17.45 per litre whichever is higher as VAT	-1035
Chhattisgarh	25% VAT + Rs.2/litre VAT	25% VAT + Rs.1/litre VAT	-896
Delhi	30% VAT	Rs.250/KL air ambience charges + 16.75% VAT	-490
Jharkhand	22% on the sale price or Rs. 17.00 per litre , which ever is higher + Cess of Rs 1.00 per Ltr	22% on the sale price or Rs. 12.50 per litre , which ever is higher + Cess of Rs 1.00 per Ltr	-391
Punjab	Rs.2050/KL (cess)+ Rs.0.10 per Litre (Urban Transport Fund) +24.79% VAT+10% additional tax on VAT	Rs.1050/KL (cess) + Rs.0.10 per Litre (Urban Transport Fund) + 15.94% VAT+10% additional tax on VAT	-321
Himachal Pradesh	25% or Rs 15.50/Litre- whichever is higher	14% or Rs 9.00/Litre- whichever is higher	-268
Manipur	36.50% VAT	22.50% VAT	-91
Meghalaya	31% or Rs17.60/Litre- whichever is higher (2% surcharge leviable only on advalorem tax)	22.5% or Rs12.50/Litre- whichever is higher (2% surcharge leviable only on advalorem tax)	-44
Jammu & Kashmir	24% MST+ Rs.5/Litre employment cess, Reduction of Rs.0.50/Litre	16% MST+ Rs.1.50/Litre employment cess	-21
Goa	25% VAT + 0.5% Green cess	22% VAT + 0.5% Green cess	-12
Sikkim	25.25% VAT+ Rs.3000/KL cess	14.75% VAT + Rs.2500/KL cess	12
Tripura	25% VAT+ 3% Tripura Road Development Cess	16.50% VAT+ 3% Tripura Road Development Cess	27
Mizoram	25% VAT	14.5% VAT	43
Uttarakhand	25% or Rs 19 Per Ltr whichever is greater	17.48% or Rs Rs 10.41 Per Ltr whichever is greater	101
Arunachal Pradesh	20.00%	12.50%	143
Nagaland	29.80% VAT or Rs. 18.26/litre whichever is higher +5% surcharge + Rs.2.00/Litre as road maintenance cess	17.50% VAT or Rs. 11.08/litre whichever is higher +5% surcharge + Rs.2.00/Litre as road maintenance cess	168
Bihar	26% or Rs 16.65/Litre whichever is higher (30% Surcharge on VAT as irrecoverable tax)	19% or Rs 12.33/Litre whichever is higher (30% Surcharge on VAT as irrecoverable tax)	672
Gujarat	20.1% VAT+ 4% Cess on Town Rate & VAT	20.2% VAT + 4 % Cess on Town Rate & VAT	795
West Bengal	25% or Rs.13.12/litre whichever is higher as sales tax+ Rs.1000/KL cess- Rs.17/KL exemption (20% Additional tax on VAT as irrecoverable tax)	17% or Rs.7.70/litre whichever is higher as sales tax + Rs 1000/KL cess – Rs 290/KL sales tax rebate (20% Additional tax on VAT as irrecoverable tax)	1746
Haryana	25% or Rs.15.62/litre whichever is higher as VAT+5% additional tax on VAT	16.40% VAT or Rs.10.08/litre whichever is higher as VAT+5% additional tax on VAT	1832
Uttar Pradesh	26.80% or Rs 18.74/Litre whichever is higher	17.48% or Rs 10.41/Litre whichever is higher	2419

Source: PPAC, SBI Research,* - indicates the GST regimne will result in revenue shortfall