The Fuel Price Conundrum

Amidst the rising fuel prices and the Opposition protests across the country, the government ruled out any immediate reduction in excise duty in order to bring down the retail prices of auto fuels.

- Only Andhra Pradesh and Rajasthan announced cut in VAT on petrol and diesel after the Central Government urged the states to take action.
- Having said that, reducing taxes on petrol and diesel is difficult because of following reasons:
  - Taxes on petrol and diesel are a key revenue source for both the Centre and states, and a cut will hit their fiscal position.

    It can be noted that there’s no Customs duty on crude, but petrol and diesel attract a Customs duty of 2.5%.
  - To narrow down the fiscal deficit to 3.3% of gross domestic product in this fiscal year from 3.5% in the previous year, the government needs to preserve (if not increase) tax revenue from fuel levies.
  - States impose the high tax rates on petrol and diesel to address the issue of high gross fiscal deficit as a percentage of their GDP.
  - Apart from taxes, the Centre and the states have other earnings like dividend income, dividend distribution tax, corporate/income tax and profit on exploration of oil and gas from the petroleum sector.
- The Government, despite of not cutting taxes may still have to bear some direct costs, since all fuel product prices are not market-linked.
  - Kerosene and LPG are subsidised to protect society's weaker section. Rising crude oil and gas prices along with depreciating rupee will raise the government's subsidy burden on Kerosene and LPG.
  - Also, higher oil prices and capital outflows push up inflation, significantly increasing the government’s borrowing costs.
  - The government's ability to give relief is only when its finances are strong, while on the other hand in an election year the spending cut is not an option since it would hamper the govt.'s spending on development schemes.

Inclusion of Petrol and Diesel under GST

- As of now LPG, kerosene, naphtha, furnace oil, and light diesel oil are under GST.
- Five other petroleum products viz. crude oil, high speed diesel, motor spirit (petrol), natural gas, and aviation turbine fuel lie outside the GST.
- Even if petrol and diesel are included under GST, prices are unlikely to fall. This is because of the GST principle of keeping rates close to the earlier tax rates.
- The international trend also suggests that if petrol and diesel are included in GST, states levy additional taxes to prop up their revenue.
- Since, the state governments levy value-added tax (VAT) on the fuel price inclusive of central excise duties, not the base price, leading to double taxation and further price amplification. GST may not stop prices from moving up, but will at least ensure no cascading effects of taxes like double taxation.

Factors Determining Fuel Prices

- **Crude:** The revision in the price of fuel corresponds to the change in the global crude oil prices on that day.
- **Rupee/ Dollar Exchange Rate:** Indian oil companies import crude oil which is quoted in US dollars, but eventually incur the expense in rupees. Thus, even if the price of the crude oil is on the fall but the rupee is also weakening against the dollar at the same time, it may offset the potential gains to oil refiners.
- **Demand-supply situation:** Short supply or low output of fuel often leads to a rise in its price; while conversely, an increase in the supply mostly results in the decrease in the price.
- **Logistics:** Petrol and diesel transported to over longer distances to cities or regions farther from depots would typically be priced higher than at the places nearer to the oil companies’ storage areas.
- **Pricing mechanism:** Daily or quaterly revision of retail prices of petrol and diesel across the country also affects the price of fuel. The government recently decided that petrol and diesel prices will change on daily basis in keeping with international rates.