NATIONAL INSTITUTE of Public Finance and Policy

One pager

No. 006

May, 2014

Designing GST for India inclusive of Petroleum, Natural Gas and Electricity: Policy Options

SACCHIDANANDA MUKHERJEE, *Associate Professor, National Institute of Public Finance and Policy, New Delhi, India. Email: sacchidananda.mukherjee@nipfp.org.in*
R. KAVITA RAO, *Professor, National Institute of Public Finance and Policy, New Delhi, India. Email: kavita.rao@nipfp.org.in*

India is working towards the introduction of a comprehensive GST covering both the Centre and the States. The rationale for this proposed reform is two fold: one, to expand the tax base available for taxation for each level of government, and two, to reduce cascading prevalent within the economy. The proposed design for GST however keeps crude petroleum, natural gas, some petroleum products, and electricity outside the purview of GST (The Empowered Committee of State Finance Ministers, 2009). Mukherjee and Rao (2014) explores some alternative designs for GST within the constraints with which governments work, i.e., reducing cascading, keeping prices in check and maintaining revenues.

If crude petroleum, natural gas, petrol, diesel, aviation turbine fuel and electricity are kept out of GST, it would result in cascading. Since, petroleum products play an important role in India's energy use, and are used directly and/or indirectly as inputs in most sectors, the proposed design would result in cascading in sectors of the economy.

However, bringing these goods into the GST regime, without any other changes in the economy, would imply that GST has to be levied at higher rates for revenues to be protected. Introducing GST at higher rates would make the reform more difficult to implement. The solution for this knot lies in making reforms of pricing of petroleum products coterminous with introduction of GST reforms.

In India, crude petroleum is predominantly imported, where imports constitute about 81 per cent of total availability. In the absence of price control, it is expected that volatility in international crude oil prices as well as in exchange rate would put pressure on domestic prices of refined petroleum products. To protect end users from high and fluctuating prices, the government implements some price control measures - the present pricing regime does not allow full and instantaneous price pass through for a few petroleum products (PDS kerosene, domestic LPG, diesel and petrol). This results in under-recoveries for oil marketing companies (OMCs). The government has not been providing compensation to OMCs for such under-recoveries in sales of diesel and petrol.

Given that the country is working towards the introduction of a comprehensive Goods and Services Tax (GST) regime, Mukherjee and Rao (2014) explores alternative configuration of the tax regime, with specific reference to petroleum products and evaluates the extent of cascading under each of these. The study also explores the configuration of revenues and prices resultant from alternative tax/subsidy regimes to understand whether elimination of price control in addition to streamlining the tax regime could be feasible, given the multiple objectives of reducing cascading, keeping a check on prices and protecting revenues.

Alternative Designs of GST

The paper shows that with the proposed regime of taxation for petroleum products and electricity in the GST, there will be cascading across sectors; with the degree of cascading varying across the sectors. The extent of cascading is non-negligible: some sectors with considerable export presence are shown to be facing tax cascading of over 2 percent of value of output which could be detrimental for competitiveness in international market. The study presents some alternative designs of taxation, without compromising on revenue considerations of government. In all of the policy options explored in the study, the estimated revenue neutral rate (RNR) is within the realm of reasonable and feasible, especially when compared to the present rates of tax which are considered as the benchmark. The study suggests two alternative designs of GST (Scenario 3 and 4) where there is no price regulation for petrol and diesel, and petroleum products, including natural gas, crude petroleum and electricity are brought under the GST. In scenario 3, the present ITC rules for use of refinery products continues, and in scenario 4, on these products, full ITC upto standard GST rate is allowed, beyond which it attracts a non-rebatable levy.

The results also show that in all the alternatives considered, the prices across the sectors either remain unchanged or decline (except for tax exempted sectors). In one of the scenarios, the announced rate of tax on petroleum products is even lower than the rates considered in the baseline. These results suggest that there is little ground for separating out petroleum products for special treatment by keeping them out of the base for GST. GST reforms implemented alongside decontrolling product prices would provide an interesting opportunity to reform without worries about price rise.

References

Mukherjee, Sacchidananda, and R. Kavita Rao, 2014. Exploring Policy Options to include Petroleum, Natural Gas and Electricity under the Goods and Services Tax Regime in India, Working Paper No. 136, NIPFP, New Delhi (May).

The Empowered Committee of State Finance Ministers, 2009. Goods and Service Tax in India:, First Discussion Paper, Government of India, New Delhi (10 November).