



## BRIEFING NOTE

# India Energy Subsidy • October 2017

### Highlights

- Petroleum products may be included in the new unified tax mechanism, the goods and services tax (GST)
- Two fuels—diesel and petrol—have seen a change in pricing policy, allowing daily revision of retail prices
- A new electricity subsidy scheme, Saubhagya, has been launched to enable last mile electricity connectivity of households
- Gradual price hikes for LPG and kerosene have been introduced with the aim of eliminating their subsidy by March 2018

## Government Aims to Slash Fuel Subsidy Bill in Next Budget

The government aims to cut its petroleum subsidy bill by more than half by 2019/20. The finance ministry presented the medium-term expenditure framework in parliament, which estimates that the petroleum subsidy will fall from INR 25,000 crore (USD 3,825 million<sup>1</sup>) in the current 2017/18 fiscal year to INR 10,000 crore (USD 1,530 million) in 2019/20 (The Hindu, 2017). The government aims to achieve this through a series of subsidy reform policies for liquefied petroleum gas (LPG) and kerosene, which is discussed further below.

## Daily Price Revision of Petrol and Diesel Introduced

In June, India introduced a policy that allows daily revision of retail prices of petrol and diesel (Shunmugam & Mukherjee, 2017). Until recently, oil marketing companies (OMCs) were setting retail prices for these fuels fortnightly. The Ministry of Petroleum introduced the pricing policy with the intention of increasing transparency and aligning retail prices more closely to international crude oil prices. With retail prices revised daily, the time lag between procurement price (what OMCs pay for crude oil) and what OMCs can charge consumers is reduced. This keeps OMC retail prices aligned to global oil prices or currencies and free from any time lags and possible volatilities that may affect their marketing margins.

<sup>1</sup> An exchange rate of USD 1 equivalent to INR 65.36 has been used.



## Minister Proposes Taxation of Petroleum Products Under the GST

The Minister of Petroleum and Natural Gas has tabled a proposal to bring all petroleum products under the goods and services tax (GST). The GST is a uniform tax mechanism introduced in July 2017 and applicable on all goods and services in India, except petroleum and alcohol. The latter two continue to have tax rates determined by states. Currently, petroleum products such as petrol and diesel are taxed twice before reaching consumers: once by the central government through a central excise tax and then again at the state level through a value-added tax. The petroleum ministry is keen to remove both taxes and move to a single GST mechanism (Hindustan Times, 2017).

The current prices of petrol and diesel are similar to January 2014 levels, before crude oil prices crashed. The government has not passed on the benefit of decreasing oil prices to consumers. Instead, it has used the fall in global crude oil price to raise revenues by offsetting the declining price with higher taxes. Excise duties, levied by the central government on petrol and diesel, have been increased nine times since November 2014. Tax revenue from petrol and diesel has increased from 0.44 per cent of GDP in 2013/14 to 1.44 per cent of GDP in 2016/17. This taxation revenue has financed the fall in the fiscal deficit, from 4.5 per cent to 3.5 per cent in the same time period (Kundu, 2017). In spite of strong protests from opposition parties, the petroleum minister stated that the current tax rates will not be slashed (Indian Express, 2017a).

In September, petrol and diesel prices were hiked again. This led to protests, particularly by various political parties in states like Odisha and Maharashtra. The government justifies its stance to not roll back prices, saying petrol and diesel are largely rich person's fuels and price hikes will therefore not affect the poor.

## Electricity

The prime minister is expected to launch a scheme under the 24x7 Power for All program, titled Soubhagya (Pradhan Mantri Sahaj Bijli Har Ghar Yojana). The scheme will subsidize electrical equipment like transformers, meters and wires (Business Line, 2017). The scheme has been allocated INR 16,320 crore (USD 2.5 billion) and is aimed at improving last mile connectivity of households. The scheme is supplementing the target of achieving universal household electrification by December 2018. Currently, the cost of last mile connectivity often has to be borne by the household. Under this scheme, those costs should be reduced, as households will now have to pay a total of INR 500 (USD 7), in 10 installments of INR 50 (USD 0.7) per month along with their monthly bills (Bhaskar, 2017).

Ujwal Discom Assurance Yojana (UDAY), launched in 2015, is a financial restructuring package for electricity distribution companies, under which state governments provide utilities with bonds to help them reduce their levels of debt. As of March 2017, 25 states and one union territory were signed up to UDAY. Utilities from these states are currently monitored against several indicators to ensure they meet targets for improvements in performance (Government of India, n.d.).

## LPG

In July, the Minister of Petroleum and Natural Gas announced the aim to gradually reduce LPG subsidies and eliminate them by March 2018. To achieve this, OMCs have been asked to hike the price of LPG cylinders (14.2-kg canisters) by INR 4 (USD 0.06) per month. Monthly price hikes of INR 2 (USD 0.03) per cylinder had been taking place since June 2016 and the recent order increases their quantum. This increases the final retail price of the cylinder; for example, in August 2017, a subsidized LPG cylinder in Delhi cost INR 477.46 (USD 7), while it was INR 419.18 (USD 6) in June 2016 (Times of India, 2017).

In India, LPG sold through OMCs for household consumption is no longer subsidized at the point of product sale. Through the Pahal system (also known under its previous name, Direct Benefits Transfer), consumers first purchase LPG at full price from OMCs and then receive a cash transfer in a bank account after purchase. However, it is unclear if, in practice, the commitment to hike the price of a cylinder by INR 4 actually amounts to a reduction in the size of the subsidy received via cash transfer.

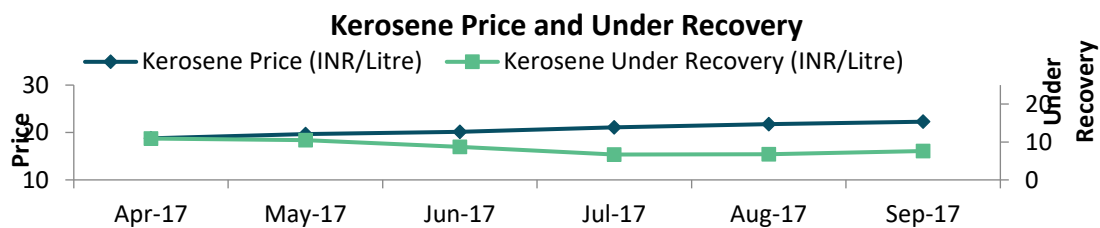
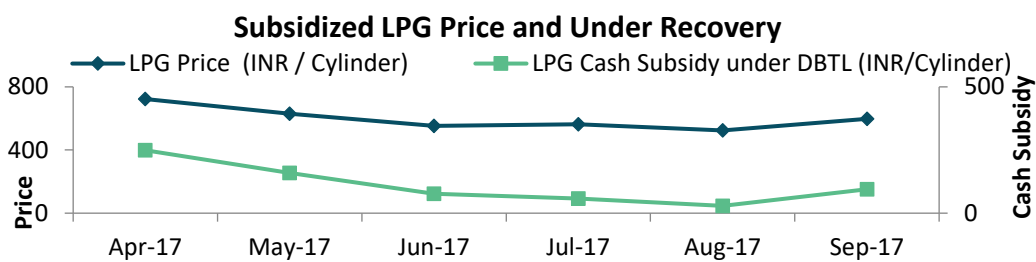
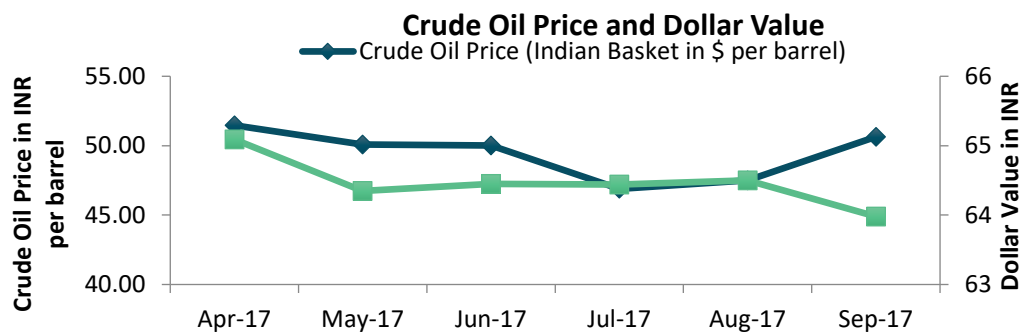


The announcement of monthly price hikes of LPG cylinders received strong disapproval from opposition parties who deemed it “anti-welfare” (Indian Express, 2017b). The minister later clarified that the government does not plan to eliminate the LPG subsidy for the poor (Money Control, 2017). However, there is no clarity if the cash transfer for LPG subsidy beneficiaries has been increased to offset these price hikes.

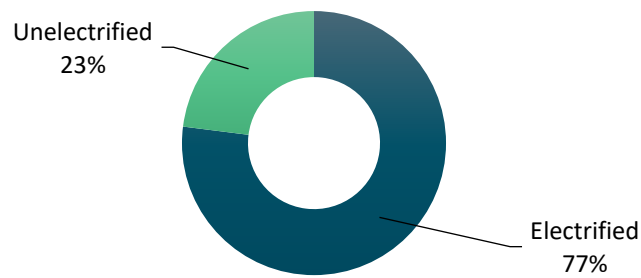
## Kerosene

The gradual price hikes for kerosene announced in 2016 are being extended until March 2018. The hikes of INR 0.5 per litre per month are aimed at bringing subsidized kerosene closer to market prices and stopping diversion of subsidized kerosene for diesel adulteration (Chowdhury, 2017). In March 2018, a review of prices will be undertaken and a decision taken if the price hikes will be renewed in the new financial year. It remains unclear if, in the long term, subsidized kerosene will continue for poor households.

## Indicators



### Household Electrification Status - Sep 2017



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### IISD Head Office

111 Lombard Avenue, Suite 325  
Winnipeg, Manitoba  
Canada R3B 0T4

**Tel:** +1 (204) 958-7700  
**Fax:** +1 (204) 958-7710  
**Website:** [www.iisd.org](http://www.iisd.org)  
**Twitter:** @IISD\_news

### GSI

International Environment House 2  
9 chemin de Balexert, 1219 Châtelaine  
Geneva, Switzerland

**Tel:** +41 22 917-8683  
**Fax:** +41 22 917-8054  
**Website:** [www.iisd.org/gsi](http://www.iisd.org/gsi)  
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