Rising fuel prices further dent stressed sectors of India's economy

The Baddi-Barotiwala-Nalagarh industrial hub in Himachal Pradesh, surrounded by a panoramic view of the Shivalik hills, is home to Asia's largest pharmaceutical manufacturing hub. It is serviced by a fleet of 13,000 trucks from small- and medium-sized transporters who have banded together to form the Nalagarh Truck Operators Union, Asia's largest truck union.

In the past, whenever the union ran into friction with industry, it held its ground. For instance, in July 2020, when the union increased freight rates in response to a hike in diesel prices, the industry expressed displeasure but gave in to the union's demand. On occasion, local politicians had to intervene between the union and industry to broker a resolution, for the union and its large membership carry political heft during elections, association members told us.

However, a year of economic disruption caused by the Covid-19 pandemic and record high fuel prices have brought the union to its knees, said members, most of whom are saddled with financial commitments and loan repayments at a time when their business has dried up in an economy that clocked its worst performance in 74 years since India's independence. In the fiscal year April 2020-March 2021, India's economy contracted by a record 7.3%.

"There's very little demand, our goods are not moving and we rarely get orders, which have dropped by about 80%," Kishan Saini, 65, owner of Delhi-Nalagarh Goods Carrier, told IndiaSpend. "Even if we get some orders and move goods to Mumbai or Ahmedabad, the trucks lay idle there because there's no load to ferry back. Most of the factories in these cities have shortage of labour and many have shut down." Now, adding to these problems, is another. "Most of the money I have is getting spent on diesel. I don't know why the government is hiking diesel prices on a daily basis," said Saini.

Even as the second wave of Covid-19 hit India this year and left a trail of economic devastation, the central and state governments have hiked taxes on fuels, pushing retail fuel prices to record highs in most of the country. In Mumbai and Delhi, petrol prices touched Rs 107 and Rs 100 per litre, respectively--about a 20% rise since January 2021.

This is showing damaging ripple-effects on an array of already stressed sectors such as transportation, agriculture and micro, small and medium enterprises (MSMEs). High fuel prices could lead to higher retail and food inflation at a time when the pandemic has eroded India's household savings and pushed millions of households into debt and poverty, economists tell us.

The government has blamed the record high fuel prices on a spike in global crude prices and a burden of flawed policies during the previous Congress-led government, whose term ended in May 2014. Economists, energy policy analysts, industry associations and trade unions IndiaSpend spoke to disagree, and blame high taxes on fuel.

Rising fuel prices push inflation

Consistently high fuel prices have pushed inflation up in the country in the past few months, the State Bank of India (SBI), India's largest state-owned bank, recently reported. This is having a detrimental effect on India's financially strained households to the extent that they were cutting back expenditures on essentials such as health and groceries in order to pay for fuel, said SBI, and called for an "urgent cut in oil prices". The Reserve Bank of India (RBI) also recently called for a reduction in taxes on petrol and diesel by central and state governments, citing rising inflationary pressures.

"It is an indirect tax on a commodity consumed by both the rich and the poor, so the relative burden on the poor is more because the tax is not calculated based on the income of the buyer; it's a regressive tax," Ajit Ranade, economist and senior fellow at the Takshashila Institution, told IndiaSpend. "But if it is leading to an inflationary impact by feeding to the cost of everything from food to steel, cement and fertilisers through increased cost of logistics for transportation, then it will get into generalised inflation. And inflation is, in a way, a kind of [additional] tax on everybody."

Taxes behind high fuel prices in India

Prices of petrol and diesel are market-determined, meaning that public sector oil marketing companies including Indian Oil Corporation, Bharat Petroleum and Hindustan

Petroleum determine retail prices of petrol and diesel based on international prices of crude oil (from which petrol and diesel are manufactured) and other related products, currency exchange rates, tax structures, inland freight costs, etc., the finance ministry informed Parliament in March. International prices are thus the determinants of prices of petroleum products in India, per the ministry.

On June 6, former Union petroleum minister Dharmendra Pradhan said that high fuel prices in India were due to rising global crude oil prices.

This is unlikely, economists say, because in fact the determinants of petrol and diesel prices in India are central and state government taxes.

Fuel prices in India remain high despite fluctuations in global crude prices, nor do they shift along with exchange rates, IndiaSpend's analysis of data since 2019-2020 shows. Retail prices of petrol and diesel went up even as global crude prices dampened, hitting a 20-year low on April 22, 2020, and the dollar-rupee exchange rate remained relatively stable.

"When Narendra Modi became PM in [May] 2014, international crude prices were about $110 but by December, prices had fallen by almost 50%. [Yet] retail prices of petrol and diesel did not drop. So what the government did commensurately was strategically increase the excise for petrol and diesel...and generally the state governments follow the Centre, so the value added tax (VAT) levied by states also went up. Essentially it became a fiscal bonanza for the government," Ranade said.

Even before the Covid-19 pandemic-induced recession, the government's fiscal position was deteriorating as the economy slowed and corporate tax collections plummeted; in 2019, the government had cut the corporate tax rate. Last year, when global crude prices registered a fall in light of reduced demand owing to the pandemic and national lockdowns, India's government hiked taxes on fuel in order to mobilise additional revenues for pandemic relief. This follows a recurring policy put into effect by the Narendra Modi government since it came to power in 2014. Central taxes on petrol went up from about Rs 9.48 per litre in April 2014 to Rs 32.9 per litre in May 2020, a nearly 250% increase, per Ministry of Petroleum and Natural Gas data. Central taxes on diesel also went up from Rs 3.56 per litre to Rs 31.8 per litre over the same period, a nearly 800% increase.

As petroleum products are not included in the Goods and Services Tax regime, states levy differing VAT rates; some also add cesses, such as for road maintenance, and some also offer rebates. All told, more than half the price consumers pay per litre of fuel goes to tax, of which the lion's share goes to the central government. For instance, for every litre of petrol purchased at an Indian Oil Corporation pump in Delhi, 57% of the payment goes to tax (34% to the central government and 23% to the state government); 39% is for the fuel itself; and 4% is the dealer's commission, according to a FactChecker.in analysis in June 2021. Similarly for diesel, 51% of payment for every litre is tax (36% for the central government and 15% for the state government); 46% for the fuel; and 3% for the dealer.

While the contribution of taxes on oil and petroleum products to the central government exchequer has grown by nearly 46% in 2020-21, the contribution to the state governments' exchequers has decreased by 1.7%.

Smaller transporters face closure

The increasing trend in fuel prices is affecting already pandemic-stressed sectors in the economy, such as transportation and logistics. "[Fuel price hikes are] easy money for the government [but] a slow poison for us," said Suresh Khosla, secretary of Bombay Goods Transport Association (BGTA), pointing to the central government's efforts to shore up its fiscal position by increasing taxes on fuel in a year when the pandemic has affected tax collections even as economic growth has plunged to record lows. "Think of [it in this way]... we are in a Titanic which is about to sink," Khosla told IndiaSpend.

"In any transportation business, diesel constitutes about 65-70% of operational costs in the form of variable cost. On one hand we are saying that for any economy, for any country, transporters form the backbone. But from my observation, the way diesel prices are increasing, most of the small truckers in this country will just vanish," Khosla said, adding that according to estimates by his association, the transport sector provides direct and indirect employment to about 20 million and 120 million Indians, respectively.

The association estimates that about 85% of India's truckers are small scale, meaning they own between 1-10 trucks each. "It will lead to a pathetic situation where the bigger players would start monopolising the sector...We have written to the finance minister, the petroleum minister that the [economic disruption wrought by the] pandemic has made it difficult for many businesses to service their loans and other financial commitments. [With] high diesel prices...how are they going to survive?" Khosla said.

For MSMEs, another 'blow after notebandi, GST & lockdowns'

Economists say that sustained high fuel prices not only have a devastating impact on the transportation sector, but could strain sectors such as MSMEs and agriculture by way of higher input and operating costs. "Even as the formal sector profits grow, employment and consumer surveys suggest significant overall job losses and decline in wages. This suggests that India's small businesses, which employ 85% of India's workforce, are under significant distress," Observatory Group's Ananth Narayan wrote in a June research note.

Narayan, who is also a professor of finance at S.P. Jain Institute of Management and Research (SPJIMR) in Mumbai, told IndiaSpend that a year of economic disruption caused by the pandemic has badly affected India's MSMEs, which number about 63 million. "I can understand inflation rising this year: Global commodities and crude prices are high. But why was inflation rising last year? This is a bit of mystery because when you have demand destruction and economic contraction, why is it that you see generalised inflation? I think there has been capacity destruction. The point being that if the Centre for Monitoring Indian Economy is right and a lot of jobs have been lost, and it is not [adequately reflecting] in formal sector job losses, then it means that at least some chunks of the MSME sector are destroyed."

Shreekant Somany, chairperson of the Confederation of Indian Industry's (CII) National MSME Council, said that according to CII's assessment, high fuel prices would have led to a 30% increase in MSMEs' operation costs. "MSMEs contribute about 40% to India's [total] exports and operate at very thin margins. So to absorb these costs is going to be a very big pressure. And given the [current] state of the economy, these business owners have very few resources to face up to the challenge. High fuel prices would drive up the freight costs by 10-15%," Somany told IndiaSpend. He added that CII estimates that about 25-30% of all the MSMEs across the country would have closed down since the beginning of the pandemic. About half of all MSMEs in India are in rural areas, and closure would lead to a trend of rural deindustrialisation.

Even before the pandemic, millions of MSMEs across the country were already reeling under financial strain. "Demonetisation and [the rollout of] GST severely eroded the competitive advantage of the MSMEs, and then the slowdown of the economy in fiscal [year] 2020 to the lockdowns in 2020 and 2021… this has been an unceasing hammer-blow to the MSMEs. What's going on right now is not just the issue of high fuel prices, but the prices of raw materials have gone up, too. This is clearly squeezing their margins," Josh Felman, senior economist and director of JH Consulting, told IndiaSpend.

Tejas Mehta is director of Tejas Metals & Plast Products in Ahmedabad, Gujarat, one of a very small number of formal sector MSMEs in India. A staggering 99.7% of India's MSMEs are in the unorganised sector, meaning they employ fewer than 10 workers; and about two-thirds of these are not registered, according to a paper by economists Santosh Mehrotra and Tuhinsubhra Giri published by the Centre for Sustainable Employment at Azim Premji University in December 2019. In 2020-21, Mehta's firm's turnover dropped by about 40% compared to 2019-20 owing to the pandemic, and he is one of the lucky ones, he told IndiaSpend. Other firms in his business have seen their volumes shrink by 95% and as a result a majority of them had to fold their business, he said.

"Our clients don't provide for [recurring] hikes in freight cost because every time there is a fuel price hike, there will be a new freight cost and this cycle creates [distrust] between us and our regular clients. So our margins go down. This is something we have to live with," said Mehta.

Farmers face higher input costs while government caps food grain retail prices

Farmers in Haryana recently protested against rising fuel prices.

Even after both the RBI and SBI have called on the government to cut taxes on oil and reduce fuel prices, citing the threat of higher inflation and the economic impact of the second Covid-19 wave, India's Chief Economic Advisor, Krishnamurthy Subramanian, is not convinced. On July 14, Subramanian said that the government wouldn't cut taxes and said that retail inflation wouldn't be affected by high fuel prices. Subramanian said his bigger concern instead was food inflation, which he said was driving retail inflation owing to a higher weightage in India's Consumer Price Index.

But economists say higher fuel prices feed into food inflation, too, and affect farmers' incomes.

Between 1990 and 2012, energy intensity of agriculture has increased in India, research by Mukesh Anand, an assistant professor at the National Institute of Public Finance and Policy, New Delhi, has found. "Energy intensity for aggregate GDP is declining but energy intensity of agricultural GDP is rising. These trends are likely to be maintained in the foreseeable future," Anand wrote in a 2016 paper. Energy intensity is a measure for energy efficiency; as an economy grows, a reduced energy intensity indicates a more energy-efficient economy, which is desirable by governments. In 2012-13, energy intensity of agriculture had risen to 32% from about 7% in 1990, signalling increased mechanisation of the sector.

Hence, Anand found that any change in fuel prices would affect the cost of farming and food prices because farmers use diesel to run tractors, harvesters, combines, water pumps and generators.

This trend could also offset any gains in minimum support prices (MSPs) that the farmers could benefit from. On June 9, Prime Minister Narendra Modi announced that the government had hiked MSPs for major kharif crops. The increase was more for pulses and oilseeds than paddy and wheat.

"The MSP is effective only in the case of crops that the government is procuring. Paddy and wheat off-take happens only from a few states such as Punjab and Madhya Pradesh. The rest of the farmers in the country are not benefiting," Anand told IndiaSpend, "The trouble is there are only a handful of farmers who produce a surplus for the market. About 85% of all farmers in India are small and marginal, whose marketable surplus of production is negligible."

At the same time, the government is keeping the price of pulses low: on July 3, it imposed stock holding limits on traders in an effort to control rising prices of pulses across the country. "If you keep holding down the final prices of the output, then it will conflict with your intent to raise farmers' incomes," Anand said.

Monty Sehgal, spokesperson of the Petrol Pump Dealers Association of Punjab, told IndiaSpend that according to the association's assessment, their sales volume has crashed by about 20-30%. "There is demand destruction," Sehgal said, and noted that among other sectors, high fuel prices were affecting agriculture in the state. "The farmers who have a budget of, say, around Rs 1 lakh [to be put into] input costs, their budget hasn't gone up even when the fuel prices have. So [we are seeing a trend] where the farmers are buying less fuel."

Even as there are growing calls from trade and industry associations for reducing fuel prices, Anand found evidence of an asymmetric relationship between a drop in fuel prices and its economic impact. "While an increase in fossil fuel prices may set in motion a rapidly widening inflation spiral, a decline in fossil fuel prices could have only a muted economic impact," according to Anand's findings.

"A drop in fuel prices does not produce the kind of cost reduction or price reduction that should [ideally] be there as compared to what happens when the prices rise. This applies across different sectors in a developing economy. The government knows this happens." Anand told IndiaSpend.

IndiaSpend has written to CEA Subramanian asking about the government's reasoning for why fuel taxes should not be cut, and whether his office has conducted any internal assessment to gauge or model the economic impact of sustained high fuel prices. We will update the article should the CEA respond.

Calls for increased welfare spending from increased fuel revenue

Under Modi's government, the share of excise fuel taxes as part of India's total tax revenue has more than doubled since 2014. Between April 2020 and January 2021, the government collected a record Rs 2.95 lakh crore revenue from fuel taxes.

Former petroleum minister Pradhan had said that additional revenue from higher taxes on petrol and diesel collected by the government would be directed toward welfare spending. However, Pradhan did not provide any details regarding how much money would go into spending and how much of it would be added as gains to the government exchequer.

Between 60-66% of excise revenue from fuel is allocated for infrastructure development, according to a petroleum ministry reply in Parliament in March.

Economists say that in the past, the government has not been transparent in its accounting about how and where it spends the revenues from fuel taxes. "There is no clarity where the fuel revenue goes. Under the current government, the revenue raised [by increasing fuel taxes] is significantly higher than previous governments. So there is a need for explanation on what this revenue has been used for," Lydia Powell, senior fellow and head of the Centre for Resources Management at Observer Research Foundation in New Delhi, told IndiaSpend. In the past, government auditors have found that there were irregularities in the deployment of cess toward development spending.

There is nothing wrong with the government raising revenues but it should be directed toward compensating people who have suffered economic losses during the pandemic, said Powell. "The issue is how you use the revenue. If you use it just for bridging fiscal deficits… just to please the markets, I don't think this is the right thing to do at this point."

"What happened for at least 2-3 years after September 2014--when international oil prices dropped--was that there were windfall gains for the government [in terms of fuel tax revenues] but we don't know how exactly these gains were used...what was the split. These are [passed on] as gains to the general exchequer; it is not earmarked, so we don't know how these are utilised. Surely, while the retail prices were high, it also translated into increased profits for the oil PSUs...so there was a profit element, too. So the shareholders of these companies benefited; [and] of course the main treasury of the government benefited," Ranade said.

According to Powell, the dependence of successive governments in India on fuel tax revenues is a concern for the economy. "See, this protest against high fuel prices is something only the opposition parties do, whether it is the Congress or the Bharatiya Janata Party. But once either party is in power, their government becomes so dependent on these revenues that they completely change their position. This trend has become rhetorical [because] nobody expects anything to be done. It's just to be seen protesting against high fuel prices," Powell said.

One of the reasons for higher taxes on fuels right now is to shore up revenue to make up for the shortfall in corporate taxes, said Powell. In 2020-21, corporate tax collection fell by about 20% compared to the previous year. "Increasing corporate taxes is too politically sensitive because if these taxes are raised, it will immediately lead to a backlash. Petrol and diesel are inelastic to prices… and [carry] low political consequences because you can blame it on anybody. So it is easy to tax it. How [does dependence on indirect taxes] impact the competitiveness of industry? How does it reduce our employment scenario? Nobody wants to discuss this because these are complex long-term problems," she added.

Narayan, of SPJIMR, told IndiaSpend that instead of pocketing additional revenues from fuel taxes, the government should ask the RBI to print money instead. "Even fiscal hawks would [vouch for] cutting down the excise duty [on fuel] and get the states to cut it down as well. There is no point in shoring up [additional] revenue from high taxes on fuel right now."

Every industry and transport association representative IndiaSpend spoke to called for clarity and stability in revision of fuel prices, which they said should be revised on a quarterly basis in order to avoid chaos in the market.

Kishan Saini, of the Delhi-Nalagarh Goods Carrier, is staggered to find the bargaining power of Asia's largest truck union diminishing. He said that various national and regional transporters' associations have approached the government to reduce fuel prices but the government has not reversed its policy. "We are going through a very bad time...even Bal Malki Singhji [President of the All India Motor Transport Congress] threatened to do chakka jam but there was no response from the government."

"The media doesn't listen to us, the government doesn't listen to us, the prime minister doesn't listen to us. Is this [country] a dictatorship?" Saini said.

Fuel Prices