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COVER STORY

On States' shoulders

CENTRE FOR BUDGET AND GOVERNANCE ACCOUNTABILITY

One of the implications of the fuel price hike is a fall in the States' share of Central tax revenues.

Table 1

Tax-GDP Ratio at the Centre and in the States – 2004-05 to 2008-09

Year	Central tax-GDP ratio	State tax-GDP ratio	Total tax-GDP ratio
2004-05	9.68	6.01	15.69
2005-06	10.21	6.18	16.39
2006-07	11.47	6.37	17.84
2007-08(R.E.)	12.39	6.48	18.87
2008-09(B.E.)	12.92	6.60	19.52

R.E.: Revised Estimates; B.E.: Budget Estimates
Source: Indian Public Finance Statistics 2008-2009

Table 2

Receipts from Sales Tax/VAT of Select States (in Rs. crore)

States/Years	2011-12 BE	2010-11 RE	2009-10
West Bengal	18307.8	14082.9	10509.6
Orissa	6882.1	5909.5	4915.1
Maharashtra	46000.0	40815.0	32676.0
Gujarat	26000.0	23995.8	18199.8

Source: Compiled by Centre for Budget and Governance Accountability (CBGA) from respective State government Budget documents.

IN view of the spiralling prices of crude oil in the international market and the growing losses incurred by oil companies, the Indian government recently announced an increase in the price of diesel by Rs.3 a litre, cooking gas (liquefied petroleum gas) by Rs.50 a cylinder and kerosene by Rs.2 a litre. This will directly afflict a vast section of the population that is already struggling to cope with the relentless increase in prices of food and other essential commodities. Further, the move will hamper the already strained finances of the States and jeopardise the various welfare programmes run by State governments if they heed the Union Finance Minister's call to all Chief Ministers to reduce State levies on diesel, LPG and kerosene.

It would be worthwhile to mention here some of the key points pertaining to the fiscal health of the States. First, under the constitutional arrangements for the distribution of financial powers and functions between the Centre and the States, the division of resources heavily favours the Central government in the bifurcated federal system of India. This imbalance manifests itself in the limits of the domain of the States in the collection of revenue and sharing of resources.

Second, while the needs of the States have grown rapidly on account of increasing governmental responsibilities in all walks of life, their revenue sources have not exhibited sufficient buoyancy in keeping with the economic growth because most of the buoyant taxes come under the purview of the Central government. Thus, most of the direct taxes, such as personal income tax (except tax on agricultural income), corporate tax and wealth tax, and indirect taxes, such as excise duty (excluding that on narcotics and alcohol), customs duty, Central sales tax (CST) and service tax, are imposed by the Centre. (In the direct taxes, apart from wealth tax, the Central government earns revenue from taxing property and capital gains. Substantial revenues are earned from these sources and their buoyancy is quite high. In the indirect taxes, CST is proposed to be replaced by goods and services tax (GST) in all likelihood with effect from April 1, 2012.)

Stagnant tax collection

On the other hand, the major sources of revenue for the States include indirect taxes such as State sales tax (State value added tax on intra-State sale of goods) and State excise duty on the manufacture of alcohol. The buoyancy of such taxes is far less than that of the taxes levied by the

Central government. It is inevitable then that the States' tax collection has not shown any significant growth over the years. It is evident in Table 1 that the tax-gross domestic product (GDP) ratio of States has been almost stagnant, while the Central tax-GDP ratio has grown.

In this regard, the situation is worse for financially weak States such as Orissa and West Bengal. Further, the States' share in Central tax revenue is linked to a formula that tilts towards efficacy considerations based on the neoliberal fiscal policies, which ultimately have led to the widening of regional disparities across States.

Table 3

Revenue Augmented by Orissa from Petroleum Sector from 2007-08 to 2009-10 (In Rs. crore)

Years	Collection during 2007-08			Collection during 2008-09			Collection during 2009-10		
Items	OST/VAT	CST	Total	OST/VAT	CST	Total	OST/VAT	CST	Total
Petrol and diesel	924.8	1.0	925.8	1067.3	0.8	1068.2	1162.1	1.6	1163.7
Kerosene	16.7	0.0	16.7	18.5	0.0	18.5	15.9	0.0	15.9
Lubricants	32.2	0.1	32.2	43.3	0.1	43.3	46.5	0.1	46.5
LPG	13.8	0.1	13.8	18.1	0.0	18.1	17.7	0.0	17.7
Others (Aviation Turbine Fuel)	26.2	0.0	26.3	21.0	0.0	21.0	14.3	0.0	14.3
Total petroleum sector	1013.7	1.1	1014.8	1168.2	0.9	1169.0	1256.5	1.7	1258.2

Source: https://orissatax.gov.in/collection.htm; accessed on July 5, 2011
OST: Orissa Sales Tax; CST: Central Sales Tax

Third, the continuing pressure of the Fiscal Responsibility and Budget Management Act, 2005, has proved detrimental to the overall fiscal health of States over and above their limited revenue base. This regulation has forced States to squeeze spending so as to keep their deficits down.

Given this situation, a hike in fuel prices might aggravate the already grave fiscal health of most of the States. There are two options with State governments: either bear the brunt of the price hikes and announce tax cuts for the common people or pass them on to the people. The situation for select States has been reviewed in this regard. Unfortunately, as regards the extent of amounts accruing as taxes from the petroleum sector, there is no readily available information in the public domain that can be marshalled to substantiate the impact of the recent hike in fuel prices on the fiscal health of a State. Available information from four States has been analysed in Table 2; two of these States, Maharashtra and Gujarat, are relatively better off, while the other two, Orissa and West Bengal, have significantly poorer fiscal health.

Table 4

Effective Rates of VAT on Major Petroleum Products In Select States as on October 1, 2010 (In per cent)

Products/State	Petrol	Diesel	SKO/ Kerosene	LPG
Gujarat	25.46	24.63	-	-
Maharashtra - Mumbai, Thane & Navi Mumbai	28.34	26.00	5	-
Maharashtra - Other than Mumbai, Thane & Navi Mumbai	27.33	23	5	-
Orissa	18	18	4	4
West Bengal	27.35	19.16	-	4

Notes : 1. Rates include cess, additional tax and VAT concession, wherever applicable.
2. Does not include entry tax, irrecoverable taxes, VAT on dealer commission and VAT on entry tax if any.
3. The current rates of sales tax/VAT as of October 1, 2010, in various States.

Source: http://www.infraline.com/ong/downstream/petroproducts/taxes/VATSTRatePetProd-6June10.aspx?AspxAutoDetectCookieSupport=1; accessed on July 5, 2011.

The table highlights the fact that revenue accruing from sales tax or VAT constituted a substantial amount of the States' total revenue from own sources. Further, the share of revenues from petrol and diesel constituted roughly one-third of the total revenue from own sources, that is, sales tax/VAT. For instance, in 2011-12, petrol and diesel account for nearly 33 per cent (Rs.8,670 crore) of the total VAT income in Gujarat (http://articles.timesofindia.indiatimes.com/2011-03-16/ahmedabad/28698671_1_petrol-and-diesel-vat-neighbouring-states, accessed on July 4, 2011). At present, State cess, additional tax and VAT concessions charged by Gujarat on petrol and diesel are 25.46 per cent and 24.63 per cent respectively.

VAT and States

In the case of Orissa, sales tax/VAT on petrol and diesel is the most buoyant source of revenue (Table 3). Orissa augmented its own revenue by about 26 per cent from the petroleum sector during 2009-10.

Table 4 provides an overview of effective tax rates on major petroleum products. Orissa collected 18 per cent of VAT on petrol and diesel and 4 per cent on kerosene and LPG. This effectively implies that any decrease in the State VAT rates on petrol and diesel (so as to alleviate the burden on the consumer) will mean a reduction in revenue for the States.

Table 5

Revenue Loss for select States owing to Cut in Customs and Excise Duties in Union Budget 2011-12

State	Share of States (out of shareable taxes, in %)	Revenue loss for State owing to cut in customs and excise duties (in Rs. crore)
West Bengal	7.2	1139.0
Orissa	4.7	749.3
Maharashtra	5.1	815.2
Gujarat	3.0	476.8

Source: Compiled by Centre for Budget and Governance Accountability, New Delhi

On the other hand, the Union Finance Ministry announced that on account of a reduction in customs and Central excise duty, the Central government stood to lose revenue to the tune of Rs.49,000 crore in 2011-12 and this revenue loss would reflect in the reduced share of the sharable pool of resources for the States (The Hindu, 'Petroleum duty cuts to cost Centre Rs.24,000 crore', June 27, 2011).

As per the recommendations of the Thirteenth Finance Commission, 32 per cent of the total Central taxes will be shared with State governments, which means that States stand to lose

Rs.15,680 crore (32 per cent of Rs.49,000 crore) as their share of Central taxes in 2011-12.

With regard to the States' share from the divisible pool, as per the formula worked out by the Thirteenth Finance Commission for different States, West Bengal will receive Rs.1,139 crore less from the Central pool for the fiscal year 2011-12 (Table 5). Similarly, for Orissa, Maharashtra and Gujarat, the respective amounts will be Rs.749 crore, Rs.815 crore and Rs.476 crore. It is worth noting here that even if States do not reduce the existing rates of VAT, cess and other taxes on LPG, diesel and kerosene, they would be receiving a lesser share from the Central divisible pool of Central taxes.

SUSHANTA PATRONOBISH

A protest in Kolkata on May 12 against the Centre's plan to increase the prices of petroleum products being addressed by Shyamal Chakraborty, president of the West Bengal unit of the CITU.

With the Central government's announcement of a price hike in diesel, it is a matter of concern that States will end up incurring huge revenue losses owing to cuts in the duties on fuels, given that some States have already taken this measure to ease the stress on consumers. Additionally, Central transfers to States may also decline significantly because of a fall in Central tax collection as a result of cuts in customs and Central excise duties on petroleum products. This will concomitantly overburden the State exchequer, especially in the weak States, whose alternative tax base remains low. Riddled with the diktat to adhere to targets under the Fiscal Responsibility and Budget Management Act, most of the States may end up reducing expenditure in the social sector and on many of the developmental activities.

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