

The Absurdity of Hiking Oil Prices*

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Between, say December 25, 2019, and June 23, 2020, world crude (brent) oil prices have fallen by nearly 37 per cent. They had fallen by over 60 per cent between end-December and mid-April, but there has been some price-recovery since then; even so, the decline in world prices till June 23 has been quite dramatic. In India however, over this very period, petrol and diesel prices have been going up sharply and are now higher than ever before; in fact diesel prices have increased even more sharply than petrol prices and the difference between the two has largely disappeared.

This increase in oil prices in India is entirely a result of the central government raising the tax rate on these products to garner larger revenue. Choosing oil as the commodity on which tax rates have to be raised however is not only inhumane, especially in the midst of a pandemic when income sources have virtually dried up for the bulk of the working people, but also senseless: it accentuates the problem of deficient aggregate demand, and hence further reduces employment opportunities, compared to almost every other means of raising resources.

The argument which the government spokesmen would put forward is that petrol and diesel are commodities which are largely used by the well-to-do; hence increasing their prices is a convenient means of raising resources without hurting the poor. But this is a completely false argument. The poor are heavy indirect consumers of petro-products through their personal use of public transport; in addition, they are hit very hard by the fact that higher oil prices, via higher freight transport costs, raise the prices of all commodities including the most essential goods. Here, the even sharper rise in diesel prices, which impinge on freight costs even more heavily than petrol prices, is particularly burdensome for the people.

The importance of freight costs for the living standard of the working people was underscored by a study done for the Indirect Taxation Inquiry Committee which found that, let alone petro-products, even the prices of “tyres and tubes” had a major impact on their cost of living.

Oil, in fact, is what is called a universal intermediary, that is, a current material input that enters into the production of every other good including even agricultural goods like foodgrains. And of all the various means of raising revenue, imposing a tax on a universal intermediary is unambiguously the most regressive.

Leave aside direct taxes, it is even more onerous in a general sense than any other kind of commodity taxation. Suppose for instance the government levies an indirect tax on some commodity which is not a universal intermediary. Then either it will have no impact whatsoever on the prices of other commodities (if it is not an input at all into the production of anything else), or would raise the prices of only a limited set of other commodities (for whom it serves as an input). But if it is a universal intermediary, then it raises the prices of every other good, including those consumed by the poorest of the poor, such as foodgrains.

Coal, oil and (non-coal and non-oil-based) electricity are the three most important universal intermediaries, which enter directly or indirectly into the production of

every commodity in the economy. Any government mindful of the hardship imposed by an inflationary squeeze on the people, would therefore refrain from raising the prices of any of these universal intermediaries; but alas not the BJP government.

This is a government known as much for its heartlessness as for its mindlessness. The Indian constitution mandates that when an asset is taken away from someone by the government to serve a “public purpose”, that person must be compensated for the loss of the asset, for the asset is a source of income. But the BJP government clearly violated its constitutional obligation of providing a compensation to the working people whose income source was taken away by the sudden declaration of a lockdown. To date no cash payment has been made to the workers for their loss of income because of the lockdown, unlike in almost every other country in the world. But to make matters infinitely worse, during this very period, it has used the taxation of a universal intermediary to garner resources, which will come largely at the expense of the working people.

This measure however is not just against the interests of the people; it is totally senseless as well. The government of late has been spending in excess of its revenue, which has increased its fiscal deficit. It wants to reduce this deficit, which is why it is now taxing oil. Now, compare two ways of raising Rs 100 for reducing the deficit: one by a uniform proportionate rise in income tax rates, and the other through taxing a universal intermediary like oil.

Since the poor do not pay any income tax, the entire burden of the rise in income tax rates will fall on the relatively better off segment of the population. Since this segment also saves a fraction of its income, a part of the tax payment will come out of its savings; its consumption therefore will be lowered not by Rs100, but by, say, 80. The reduction in demand caused by the reduction in the fiscal deficit will be Rs 80.

But if the same Rs 100 is raised by taxing oil, a part of the burden falls on the poor, who have almost zero savings; it is only the remaining part that falls on the segment of the population which saves. Hence while raising Rs 100, say Rs 50 comes from the poorer segment that does not save and Rs 50 from the better off segment that does, and this Rs 50 in turn reduces consumption of the latter by Rs 40 and savings by Rs 10 (assuming an impact of tax payment on consumption and savings in the same ratio as in the above example, ie, 80:20). The total reduction in consumption because of the tax therefore is Rs 50 (from the poor) plus Rs 40 (from the consumption of the better off segment), which comes to Rs 90. Taxing oil in other words, precisely because it squeezes the consumption of the poor, reduces demand to a much greater extent than raising income tax revenue.

By far the best way of reducing the fiscal deficit is through wealth taxation. Since wealth taxation falls on the very rich, whose consumption levels are hardly affected by tax payment, Rs 100 of wealth taxation levied upon them more or less entirely comes out of their wealth (or savings) with negligible reduction in consumption. In this case, the reduction in demand will be zero. This way of reducing the fiscal deficit therefore will cause no reduction in employment.

Finally, suppose the government did not do anything to reduce the fiscal deficit; then again there would be no reduction in aggregate demand and hence in employment and output. But since any fiscal deficit is financed by borrowing, ie, putting claims upon

the government in the hands of those who save in the private sector, it increases wealth inequality in the country. It puts wealth in the form of government securities in the hands of the saving segment, and hence the better-off segment, of the private sector.

It follows then that wealth taxation is the best option, since it does not increase wealth inequalities and does not reduce aggregate demand. Keeping the fiscal deficit going, increases wealth inequality but does not reduce aggregate demand. Taxing incomes does not increase wealth inequality but reduces aggregate demand somewhat, while taxing oil, though it does not also increase wealth inequality, has the most damaging effect of all on aggregate demand. From the point of view of aggregate demand and wealth inequality, wealth taxation is by far the best option. In its absence the government would do better by resorting to some other form of direct taxation rather than taxing oil. Taxing oil is the worst among all tax-options since it has the most deleterious effect on the level of output and employment.

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