Funding clean energy shift

Taxes on fossil fuels can be used to manage the transition

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Ever since India introduced the Goods and Services Tax, debates have been going on about the need to bring petrol, diesel, ATF, natural gas and crude oil within the ambit of the GST. With rising fuel prices, the debates have become more heated.

The recommendation of the Finance Commission to re-examine the GST rate structure has provided an impetus to include these products in the general discussion on taxation under GST. In this context, two views have been hogging the limelight. First, a report by SBI economists makes a case for bringing the products under GST at 28 per cent with some cesses thrown in and presents the gain as a decline in the prices for consumers.

Second, some State finance ministers have agreed to accept this change, conditional on compensation for any revenue loss. Underlying these two views is the notion that the idea is inherently acceptable — the only question being one of revenues or of timing the reform.

To provide an alternative view, one can add an additional challenge that needs to be addressed. The government has committed to reducing the carbon content of economic activity. Specifically, by 2030, it has committed to reducing emission intensity of GDP by 33-35 per cent when compared to 2005 levels.

Many initiatives

As a part of this overall goal, a number of initiatives have been announced including transforming India's vehicular composition to include 30 per cent electric vehicles, 100 per cent electrification of trains by 2023 and making the Indian Railways a zero net emitter by 2030.

This commitment on greening of investment and incomes can have two implications for government finances. First, if the aforesaid goals are sought to be achieved through changes in regulations and investments, the demand for fossil fuels would reduce, implying thereby a drop in a buoyant source of revenue.

At present, the government collects significant amounts of revenues from petroleum products — in 2019-20, levies on petroleum products contributed 20 per cent to the indirect tax collections. There was a surge in cesses levied by the Centre in 2020-21, implying an even higher revenue share. It is critical for the governments to plan a transition to lower dependence on taxation of fossil fuels.

Second, the transition to a low-carbon model of economic activity would require substantial investments not just in clean sources of energy but also employment. The transition to cleaner energy sources is expected to result in a substantial decline in employment opportunities. For example, renewable energy generation does not involve any "inputs", while fossil fuels require extraction and refining both of which generate employment.

In this context, it is interesting to ask whether taxes on fossil fuels can be used to manage this transition. The transition involves three components: (a) reduce the growth in demand for fossil fuels; (b) generate resources to aid investment in green activities and to augment employment capacity in the economy; and (c) reduce dependence of government finances on taxation of fossil fuels in the medium term.

The demand for fossil fuels in most countries is price inelastic. In such cases, increasing taxes on fossil fuels generates resources with a less-than-proportionate reduction in demand. Thus, taxation can be used to put a lid on growth of demand for fossil fuels, without the sector collapsing completely.

These resources can be earmarked for supporting investments required for implementing the transition. Given that the costs of power generation in renewables have declined considerably over the last few years, the need to support the renewables sector need not be high priority. Instead, the resources can be used to augment investments in other green activities with good employment potential,

By earmarking the revenue for specific uses, the budget for the day-to-day functioning of the government can be separated from the volatility of energy taxes. Interestingly, in an economy facing sluggish demand, when private investments do not pick up, an agenda built through a change in regulation emphasising on green activities can step up investment and kickstart the economy which in turn would reduce the dependence on taxation of fossil fuels.

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