

## **8. Economic and Fiscal Impact of Royalty Rates of Coal and Lignite in India**

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The coal sector has huge revenue potential. It provides a good revenue base to the coal producing states. The Plan document (Ninth Plan) emphasises the need to examine the important non-tax source, namely, royalty on coal to augment the revenues of the coal-rich backward states.

No research study is available on the above subject. However, the Commission on Centre-State Relations (Sarkaria Committee) had raised important issues relating to coal and other mineral royalties. There were study teams appointed to look into the coal royalty by the Department of Coal. Most of these reports are confidential.

The present study attempts to fill the gap.

### **Objectives**

- To examine the prevailing system of coal royalty in India and the rationale of fixing and revising royalty rates,
- To analyse the revenue implications of revision of royalty and the methods of fixing the quantum of royalty and its rate on state finances,
- To examine the effect of royalty on the prices of coal, performance of the coal companies, major coal consuming firms, exports and imports of coal; and
- To suggest policy measures needed to rationalise the coal royalty policy of India.

Coal belongs to the states. However the price of coal and the royalty rates are fixed by the central government. Royalty is an important source of non-tax revenue of the coal producing states.

### **Royalty Issues in India**

In chapter 1 various issues pertaining to royalty on coal are raised both from the angle of coal producing states and from the angle of the central government. Royalty accrues to the states but the central government fixes the royalty rate, mode and frequency of its revision. The state governments collect and appropriate royalty. The study brings forth that royalty is an important source of non-tax revenue to the coal producing states. The categorisation of coal, rates of royalty, periodicity of revision of royalty rates, and basis of royalty influence the quantum of revenue accruing to the states. Thus, revenue from royalty to the states depends upon the policies pursued by the central government.

Chapter 2 brings out that the coal sector contributes to the Centre and the States not only royalty but also revenue through various other levies, freight and by contributing to the thermal power production sector. There are several levies like sales tax, CST, royalty-linked cess, Stowing Excise Duties; revenue mobilisation through environment protection measures, and so on. Royalty accounts for about 60 per

cent of revenue mobilised by various states from coal. The final landed price of coal is influenced not only by changes in the royalty rates but also by other levies, which account for 40 per cent of the revenue accruing to the states from coal.

In chapter 3 policies relating to royalty and cess are examined in detail. The study shows that the royalty rates have not changed very frequently. They were revised only four times during the past 27 years. So also the royalty rates for lignite remained unchanged for long. It was held that royalty rate on lignite should be linked with royalty rates on the grades of non-coking coal of equivalent heat value.

Chapter 4, which highlights the revenue implications of coal royalty, finds that royalty as a source of revenue to the coal producing states is losing its importance since nationalization of coal-mines in the year 1971. Royalty is not linked to the price of coal. Since it remains unrevised for long its contribution falls in real terms and also as a percentage of coal price. Royalty revenue improves only in the years when the rates are revised. Royalty as percentage of SDP and state revenue is on the decline. There have been frequent upward changes in the basic price of coal but the royalty rates remained stagnant for long.

Non-revision of royalty rates for many years leads to decline in the real royalty income of the states mainly due to increase in the inflation rate. States lose about Rs.250 to Rs.300 crores every year when royalty is based on production but the rates remain static for long. The royalty rates also differ from one grade to the other. There is no rational basis for fixing royalty by grade. It was observed that while for low-grade coal royalty is high, for high-grade coal it is less. States with higher grade coal, e.g., 'E' grade, get the same royalty as states with inferior 'G' grade coal.

In chapter 5 economic impact of royalty on coal is assessed. The Centre argues that a rise in the price of coal due to increase in the royalty rates makes the domestic coal industry lose its market. However, the present study refutes this argument. The final landed price of coal is influenced more by the pit head price of coal and railway freight rather than by royalty.

The coal producing states rightly feel that the coal prices are frequently increased to benefit the companies and the Central Government.

Keeping in mind the definition of royalty, it will be rational to de-link royalty from the performance of the coal companies.

As coal supply is less than the demand and it is likely that the gap will increase further in the coming decade, import of coal is not going to adversely affect the domestic coal market.

The study brings forth that the royalty rates are fixed on *ad hoc* basis without any economic rationale. Several apprehensions about the adverse impact of increase in the rates of royalty on the final consumer prices of coal consuming products, on domestic coal's competitiveness, on coal production, on exports and imports do not get any logical support.

The royalty on coal should not be linked with the competitiveness of the coal industry. Royalty is fixed through an agreement between the lessor and the lessee. As per the agreement, whether the coal

producing company has profit or loss or is in a position to compete with imported coal, royalty has to be paid to the lessor. It will be rational to de-link royalty from the performance of the coal companies.

The study supports the claims of the coal producing states. Coal producing states have been insisting on two general issues, (i) frequency in the revision of royalty rates and (ii) fixing the rates on ad valorem basis. Similarly there is a case for shifting specific royalty on coal to ad valorem royalty to avoid erosion of the coal resource base of the states in real terms. There are several grades and types of coal and the royalty rates differ from one category to the other. Lignite rates are different from coal rates. SCCL rates differ from CIL rates. Royalty rates differ from State to State like in Meghalaya and West Bengal. There is need to reform the system and to simplify and rationalise coal royalty in India.

Hence, it may be concluded that there is a need to reform the royalty system and derive rational rates of royalty, which can provide a stable source of income to the coal producing states without distorting the consumer preferences, domestic coal market and exports and imports.

### **Policy Recommendations**

In order to arrive at a rational royalty system, it is important to choose the royalty base properly. It is also important to determine the level of royalty revenue that can be mobilised without altering the economic decisions of the consumers and producers of coal. The royalty needs to be based on the value of coal produced rather than on the quantum of production. This necessitates changing over from the existing royalty system, which fixes the rate of royalty on per ton basis to the value of coal production.

### **Reforms within the Existing Legislation**

If the existing system of royalty, wherein royalty rate is based on the quantity i.e. on per ton basis and is reviewed not before three years, the following questions should be answered while taking steps to rationalise the royalty system:

How much revenue should be mobilised through royalty? Different states have suggested different percentages of royalty ranging from 10 per cent to 20 per cent. Some states supported royalty to be on a per ton basis and suggested rates varying between Rs.6 per ton and Rs.20 per ton. However while fixing the rate of royalty the burden of other levies on coal, the pit head price and the freight charges need to be borne in mind.

Increase in the rate of royalty and increase in the revenue from royalty should be linked with the growth rate of GDP coming from the fuel and mineral sector (Gwy) and with the rate of inflation (Pr). The benefit from the value added by the fuel and mineral sector to the GDP should also benefit the coal-producing sector. Hence, while fixing the target for revenue mobilisation, the expected growth of GDP through the coal (fuel) sector should be considered. The future revenue to be mobilised should also take into account the inflationary rate.

## **Ad Valorem Rates of Royalty on Coal and Lignite**

The second alternative is to simplify the coal royalty system by making it ad valorem. The royalty rates on coal all over the world except in India and the Australian State of New South Wales are on ad valorem basis.

If ad valorem basis is adopted, there would not be any need to keep six groups of coal, as in the present arrangement. One option was to have two groups, coking and non-coking coals. However, it may be noted that at present, A & B grades of non-coking coal are included in Group II along with coking coals of Washery Grades II and III and semi-coking coals of Grades I and II. Similarly, C grade of non-coking is included in-group II along with coking coal Washery Grade IV. Keeping in view these existing arrangements, there can be two rates of coal royalty 20 per cent royalty rate on ad valorem basis on Group I coals and 15 per cent on ad valorem basis on Group II coals.

Switching over to ad valorem system has several advantages, especially now when the country is contemplating adopting Value Added Tax system. All indirect commodity taxes will be based on the concept of Valued Added. Hence, if royalty is also based on the concept of ad valorem it will strengthen the economy.

Ad valorem based royalty has the advantage of simplifying the royalty system. There will be, at the most, two rates, one for coking and the other for non-coking coal. This will stop the practice of recording the sale of high-grade coal under the category of low-grade coal. Even the estimation procedure becomes very simple. There is no need for the states to keep requesting the Centre to revise the royalty rates. The ad valorem based royalty has built in flexibility and as and when the price of coal increases the revenue from royalty also increases. The Centre can review the ad valorem rate once in five years and can re-fix the share of the states.

Considering the advantages of the royalty system based on ad valorem principle, it is high time that the Centre took a definite measure to switchover to this system. However, there is need to examine the rationale behind fixing the royalty amount and rate of royalty in a scientific manner. The rate should be neutral to the decisions of the economic agents. A system that is simple and transparent and facilitates estimation of the quantum of royalty is desirable for the country.