Brief summary of the Study

on

ALTERNATIVE ROAD MAPS ON REFORMING DIESEL PRICES IN INDIA

Diesel, petrol, LPG and Kerosene are among the most important petroleum products in India. Out of them, diesel constitutes 38% of petroleum products consumption. Hence, Indian Govt. has long maintained a price control on diesel considering it as a "sensitive commodity". But the mechanism chosen to maintain this price control has been questioned time & again and there are concerns regarding the overall impact of this price control regime.

First, there are large under recoveries to the oil companies due to low diesel prices compared to international prices. They are not compensated on time by government which will make these oil companies unviable in the long run. Also, when these oil companies are compensated from central government, it creates huge burden on government treasury and worsens fiscal deficit. As known, fiscal deficit is one of the reasons of increasing interest rates & inflation & it crowds out private investment.

Also, compensation given to oil companies to keep diesel prices low is a form of producer subsidy. So it benefits all the consumers of diesel equally irrespective of their ability to pay. Hence, rich people are unintended beneficiaries of this diesel subsidy which cannot be justified. In fact, the data reveals that only 6% of diesel subsidy goes to poorest 20% of population & majority of subsidy is cornered by people from middle class & rich class.

Another important concern is that, diesel is effectively getting substituted for petrol & furnace oil due to large price difference. Diesel car sales have shot up compared to petrol run cars. Furnace oil is being replaced with diesel by industries for power generation.

It is clear then that diesel subsidy mechanism needs to be reformed & diesel prices needs to be increased to align with the international prices. In the past years the government policy approach on pricing of petroleum products has moved between cost-based pricing, import parity pricing (IPP), trade parity pricing (TPP) and free market pricing to administered price mechanism (APM).

The Parikh Committee report (2010) on " A Viable and Sustainable System of pricing of petroleum Products " had recommended that diesel prices should be deregulated and should be determined by the market at both the refinery gate and retail levels. The government while accepting the recommendations has not so far deregulated the diesel prices. Unfortunately the world market prices of crude oil and petroleum products have gone up since then. The price of Indian basket of crude oil was around $70/barrel in January 2010 and in June 2012, it has become $92.08/barrel. As a consequence the under recovery on account of the subsidized diesel have gone up steadily. For 2011-12 it is around Rs. 9.13/litre or Rs.81, 192 Crore in total.

Diesel price reforms are mainly not implemented due to the concerns regarding its possible adverse impact on various stakeholders. Main stakeholders are consumers, specifically poor people, farmers, freight transport dependent on diesel, diesel car drivers & industry and telecom tower operators.

In India, essential goods including food items are carried by trucks to markets. Hence, if diesel prices increase, it is expected to lead to higher transport cost, higher prices of essential commodities & lead to inflation. In agriculture as well, running costs of diesel pumps & tractors would go up with diesel price hike. Passenger transport will also be affected as the diesel cars can no longer use cheap fuel. Telecom towers have started using diesel generators to ensure the uninterrupted power supply; their operating costs will also go up with diesel price hike. On the other hand, large under recoveries lead to higher inflation over time. The issue of inflation is complex. Diesel price hike can lead to inflation but diesel price subsidy as well causes inflation through fiscal deficit channel. Thus one needs to compare the impacts due to raising price with impacts of not raising it.

The report addresses these stakeholders concerns in detailed manner and analyses the real impact of alternative diesel price policies on various stakeholders.

Hence, IRADe has built a model to assess the relative impact of diesel price hike visa-a-visa diesel price subsidy's impact on inflation (measured by WPI), real interest rate and GDP. Following four scenarios for 12 quarters beginning from the 1st quarter of 2012-13are built to assess the impact –

1) No change in diesel price (No Change)
2) Immediate increase of 30% in diesel price and its de regulation (One Shot 30)
3) 6.78 % increase every quarters to reach an increase of 30% by the 4th quarter (4 Quarter)
4) 10% increase in diesel price (Partial 10)

IRADe has also explored the impact on consumption expenditures of different classes of consumers of inflation caused by increase in diesel price. We have also explored diesel price policy on others such as car owners, telecom tower owners, etc.

The results of IRADe research will be presented at the workshop, which will provide an opportunity to discuss them from the perspectives of various stake holders.