In India: Why is Petrol Price So High, When that of Imported Crude Oil is Low

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Abstract

The purpose of this paper is to study the petrol prices in India so high, when that of imported crude oil is low? International crude oil prices experienced a sharp increase in the recent period. Economic growth is inextricably linked to energy. Energy is required for almost all economic activities. Petroleum which comprises of crude oil and refined petroleum products is one of the prime sources of energy in the world. The central problem that nations worldwide have consistently been facing is that this crucial non-renewable energy resource is scarce and is primarily concentrated in a few countries/regions of the world. The surplus production capacity of petroleum is largely concentrated in Middle East and West Asia. This imbalance in distribution has serious implications on the growth as well as energy security of countries that are not self-sufficient in terms of indigenous production of petroleum and are largely dependent on imports from aforesaid regions to fuel their economies.

Coming to India, although the petroleum industry of the country is one of the oldest, India is one of the least-explored countries in the world. In 2005-06, the balance recoverable reserve of crude oil in India stood at 786 million tones and the annual production of crude oil was only around 33 million tones. The annual demand in that year, however, was more than 130 million tones, thereby calling for huge imports of crude. In fact, given the burgeoning growth in oil consumption attributable to the rapid growth of the Indian economy post 1991, coupled with supply-side constraints, such as insignificant domestic supply of crude low reserve accretion and inadequate availability of appropriate substitutes, among other factors, made India emerge as a major net importer of oil. Thus, this study would try to empirically test this relationship between; in India why petrol price is so high when that of imported crude oil is low.

KEYWORDS: Inflation, Transmission Mechanism, Price Fluctuations, Administered Price Mechanism, Oil Price, Indian Petroleum Industry, Government Policies, Effect on general public.

Introduction: It is common knowledge that price of fuel in India depends upon the global crude oil prices. The rise in petrol and diesel prices has been making news since few years. India has persistently been depending on the imported crude oil to meet the lion’s share of its requirement. The import dependence for crude and consequent vulnerability of the country to oil price shocks has exacerbated over the recent past owing to rapid growth of the Indian economy post 1991 that has fueled the rapid growth in oil consumption.

Given the paramount importance of petroleum for Indian economy and its increasing import dependence on this front, the domestic pricing of crude oil and petroleum products assumes enormous significance for country. The pricing regime not only influences the cost of energy for economy as a whole but also has significant implications on economic growth and welfare. The pricing of crude and petroleum products in country has been influenced by a multiplicity of politico-economic factors and interests of various actors and interest groups involved in the matrix, such as consumers, particularly the vulnerable sections, the producers, refiners, marketing companies, and the government.

Crude oil price is one of the most significant microeconomic variables which affect the cost of production directly or indirectly. The purpose of this study is mainly to understand the government policies for petrol sector and identify major causes for this amplifying rise in petrol prices and its adverse effect on general public of India. The petrol prices rise mostly because of the cost of the crude oil and refined products in the international market and government's pricing policy and absence compensation to oil companies.

Objectives:

1. To study the Prospect of International Crude Price?

2. To study the current trends in Indian Petroleum Industry

3. To study the why is petrol price so high in India when that of Imported Crude oil is low?

Research Methodology:

The study is based on the secondary data. The paper attempts at descriptive analysis based on the secondary data sourced from journals articles and media reports. The secondary data collected from various books, national and international journals, Government reports, publications from various websites which focused on various aspects of Impact of Oil Price Fluctuations on Indian Economy.

What is the prospect of international crude price?

International crude oil prices experienced a sharp increase in the recent period. From a 25 years' low of USD 11 per barrel in February 1999, the reference price of crude oil used by the International Monetary Fund (IMF) increased to a peak of almost USD 35 per barrel in the first week of September 2000. All oil-importing countries faced the specter of this 'oil shock' and India, being a net oil importer was no exception. Although burden of the price increase at the international market was not fully passed on to domestic consumers in India, the combined oil pool deficit exerted pressure on Government finances, affecting macroeconomic outlook and inflation in ensuing year. The world economy has witnessed 4 bouts of oil price shocks in the past thirty years, viz., 1973-74, 1979-80, 1990 and recent one from early 1999. Oil price hikes typically generate cost-push inflation that leads to fall in output and shifts in terms of trade. The recent increase in oil prices has come after sustained ebb in inflation in the developed countries. Favorable global economic conditions such as unutilized capacity and low underlying inflationary pressure have helped developed countries greatly in moderating the adverse impact of oil shock. However, developing countries may be affected more than developed countries due to the lack of oil- conservation techniques and absence of appropriate oil substituting technology in the production process.

I would be surprised if the price of crude exceeds USD 80 per barrel. This is because the USA produces much more oil and gas than before and has a potential to produce even more. Also, Organization of the Petroleum Exporting Countries (OPEC) should be wary of the long term impact of higher oil price as it would accelerate the development of electric mobility, public transport, smaller and more fuel efficient vehicles. OPEC’s short term gain from raising crude price may be more than offset by their long term losses.

There is still a significant difference between price of diesel and price of petrol, due to differential rates of excise tax imposed by Central Government, which is further accentuated by differences in VAT rates imposed on diesel and petrol by states. This price differential distorts consumer allocation and is not desirable.

The current trends in Indian Petroleum Industry:

India was the fourth-largest consumer of oil and petroleum products after the United States, China, and Japan in 2013, and it was also the fourth-largest net importer of crude oil and petroleum products. The gap between India ‘s oil demand and supply is widening, as demand reached nearly 3.7 million barrels per day (bbI/d)in year 2013 compared to less than 1 million bbl/d of overall liquids production. Despite having large coal reserves and healthy growth in natural gas production over the past two decades, India is increasingly dependent on imported fossil fuels. Current petroleum and natural gas minister, Dharmendra Pradhan, who took office in late May 2014, reiterated the goal of making India self-sufficient in energy resources. India is looking to further develop and harness its different renewable energy sources. These actions would effectively increase India‘s energy supply significantly and create more efficiency in energy consumption. India already began implementing oil and gas pricing reforms over past two years to foster sustainable investment and help lower subsidy costs.

The Indian Government has controlled prices of a number of petroleum products. The most important of these products being petrol, diesel, and liquefied petroleum gas (LPG) and kerosene. Consumers are charged a low price and difference in the sales realization of the Oil Marketing Companies (OMCs) and their cost of supply, called ‘under recoveries’, were financed by contributions from the Government, OMCs and upstream oil companies. The under recoveries were large as the Government fixed sale prices quite low compared to the cost of supply. Following the Report of Expert Group on Viable and Sustainable System of Pricing of Petroleum Products, the petrol price was freed and linked to import price of crude oil and market determined. Diesel price was however not liberalized due to a concern for inflation caused by increase in its price.

At present petrol and diesel prices are determined by cost of import of crude oil and the sale price reflects cost of supply. Since 70 percent of our consumption of petroleum products is based on imported crude oil, this makes sense. A question that is frequently raised is why the petrol price is so high when the cost of import price of crude oil is not that much. The price of Indian basket of crude oil has ranged from USD 112 per barrel in year 2011-12 to a low of USD 46 per barrel in 2015-16. The price in April 2018 is USD 77.90 per barrel. The sale price of petrol and diesel in Delhi 8th April 2018 were INR 74.03 and INR 64.96 per liter. The prices at which a dealer gets petrol and diesel are much lower and difference is largely due to the excise tax imposed by the central government and the value added tax (VAT) imposed by the state governments.

The table below shows how prices are built up in Delhi. Price (Rs/Liter) buildup of Petrol and Diesel 8th April, 2018

Sr. No.	Title	Diesel	Petrol
1	Dealer Price	37.54	35.21
2	Central Excise	15.33	19.38
3	Dealer Commission	2.52	3.60
4	State VAT	9.57	15.74
5	Sale Price	64.96	74.03

Source: Indian Oil Corporation website.

The taxes increase the sale price of petrol by more than 90 % over the dealer price including commission and that of diesel by more than 60 %. While the central excise tax is specific the state VAT is ad valorem.

In India, why petrol price is so high, when that of imported crude oil is low:

Common man already burdened with inflationary pressures, increased petrol prices will further shrink the real household incomes. There have been strong reactions from opposing political parties as well as sharp reactions from the general public against the price rise. The primary reason behind increase in petrol prices is the rise of dollar against rupee. We need to understand why rupee is depreciating against dollar like a free fall. One of the many reasons cited for depreciation is the ongoing euro crisis. The government‘s fiscal deficit is increasing i.e. government is spending more than it is what it is earning. This is because increased expenditure is not matched by increased tax rates. Hence, people are left with more money, out of which some money is diverted towards the imports which results in more imports than exports leading to trade deficit. The major portion of our imports is oil. Since the oil imports have to be paid in dollars, the importers need to buy dollars and sell rupee leading to more demand of dollar and excess of rupee in the market.

The prices of petrol have been increased. This will have effect on trade deficit and rupee-dollar value but in order to have significant effect, government needs to increase the price of diesel, LPG and kerosene. An increase in prices of these will help government reduce its fiscal deficit that is less borrowing from the market leading to more funds available for the private investment. Resulting in better economic growth. However, petrol hike directly or indirectly affects all major sectors like transportation, textiles, auto, FMCG etc., for manufacturing & transportation. This affects the prices of daily essential commodities which are transported on a day to day basis. Banking sector is also expected to suffer due to the high inflation level. Increase in fuel price will also increase in food price. This will have a severe impact on poor people because poor households spend more than half of their income on food and only a tenth on fuel. It is a chain reaction once started will affect all. Increase in petrol price will increase transportation cost, increase in transportation cost will increase price of goods, and this increase in price of goods would eventually force people to loosen their pockets even more, and so on like this, the chain will propagate further. These ups and downs push more people into poverty, leading to a more pathetic situation of those who are already poor. This has obviously sent shock waves to common man who is trying hard to make both ends meet. Price hike affects only the low wages or fixed salaried middle class families compared to higher wages salaried class.

Petro-products are one of the key sources of revenue for Governments at both Central and State levels. One of the key questions for price rationalization of petrol and diesel will be its budgetary implications. The excise revenue was 23 percent of the total tax revenue (inclusive of States' share) of the Central government in year 2016-17 revised budgets. The excise revenue from petrol and diesel constituted 85 % of the total excise revenue and 19 % of Centre's total tax revenue. The government is naturally wary of tinkering with this excise revenue from diesel and petrol. It could however, rationalize differential excise rates on petrol and diesel in a revenue neutral way. Since diesel consumption is 3.5 times as large as the petrol consumption, a one-rupee increase in diesel tax rate can lead to a 3.5-rupee reduction in the excise rate on petrol.

Any change in excise duty rates will have consequent impact on VAT collections (as VAT is calculated as a percentage of prices including excise duty). The importance for States' budgets revenue from VAT on diesel and petrol is also significant. VAT rates vary from state to state.

Madhya Pradesh (MP) levies the highest VAT rate on petrol of nearly 40 %. The VAT rate on Petrol exceeds 20 % for all but two states of the 24 states. Most states impose a lower VAT on diesel excepting Gujarat and Odisha where rates are equal and Goa where the rate on diesel is higher. The revenue from VAT on petrol and diesel constitutes around 10 percent of states' budgets.

Therein lays the states' reluctance to bring petroleum products under GST i.e. goods and services tax regime. Even the maximum GST rate of 28 %, of which states' share will be 14 %, will lead to a drastic reduction in their revenue from VAT on petrol and diesel at present. 14 % share on a price of around Rs 40 per liter (cost to dealer plus dealer commission) means states will collect around Rs 6 per liter. Whereas today, states collect around Rs 10 per liter of diesel and Rs 15 per liter of petrol. This makes it very difficult to arrive at an acceptable GST rate that protects states revenues. This is why petrol and diesel are kept out of GST. Hopefully, once confidence in the GST regime is built up, mechanisms can be found to get agreement from states about bringing them gradually under GST. Over the transition period states may have to be compensated for their loss in the revenue. This will become possible if GST leads to substantial increase in the tax collection.

Conclusion:

Dependency on oil means that, theoretically, oil price fluctuations are bound to have far reaching and serious impact on the Indian Economy. India faces the impact of imported inflation, which is general price level rise in a country, because of increase in prices of imported commodities. A viable and sustainable pricing system for petroleum products is a key requirement of stable, long term growth of the economy. It is therefore important that oil companies should have freedom to set prices based on competitive market conditions. The government needs to extend subsidy to targeted consumers in such a manner which does not impinge on the freedom of oil companies to set prices in market place.

There is an urgent and important need for development of non-conventional (including renewable) sources as a substitute for conventional sources to meet energy needs. Energy subsidy reforms along with regulations, standards, and the targets directing the efficient level of utilization of oil as a fuel are very important to reduce dependence on oil imports.

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