

Petroleum Subsidy Removal: A Way-out

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Abstract

By summarizing subsidy & tax structure of four sensitive petroleum products (Domestic LPG and PDS Kerosene, HSD & Kerosene), this paper tries to demonstrate that consumers are paying more for these petroleum products despite the subsidy mechanism of the government that is meant to contain their prices. It then tries to recommend way-out, that provides a step forward in reducing subsidies on these petroleum products.

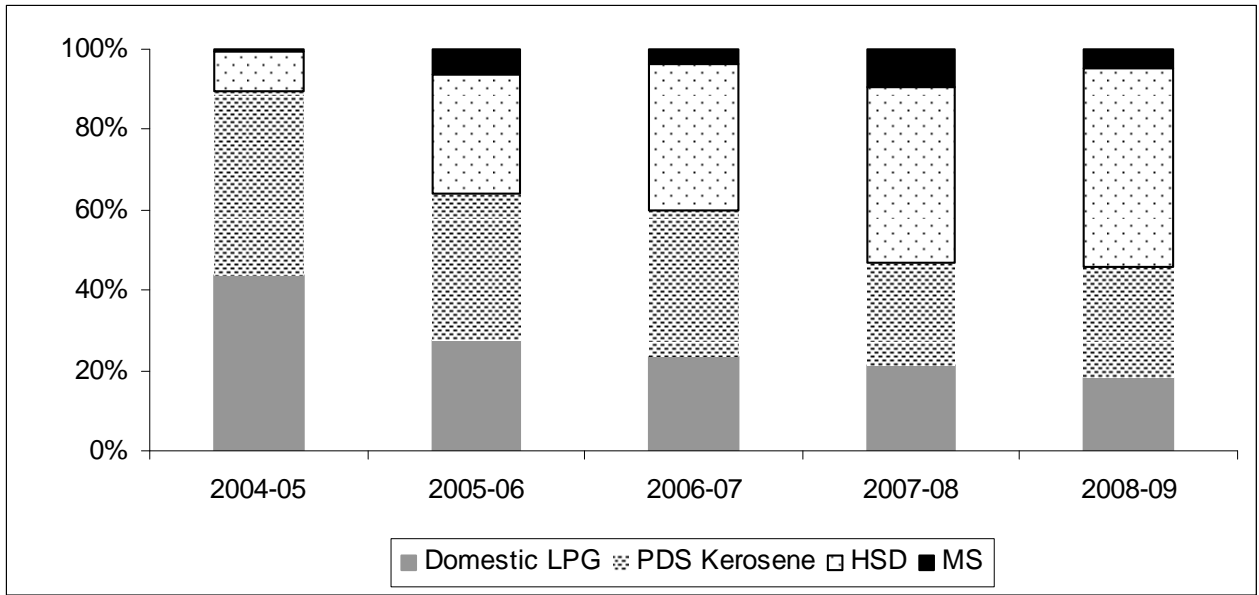
Introduction: *Why Petroleum Subsidy Removal?*

Subsidies

The system of subsidy for Domestic LPG and PDS Kerosene is an issue of greatest concern not only for the Oil Marketing PSUs but also for the consumers today due to volatile crude oil prices which has been fluctuating from the \$45/bbl level to \$150/bbl and back to \$30 per barrel in last two years. Although, in technical terms, the Government is providing subsidies only for Domestic LPG and PDS Kerosene, it is giving support to Oil Marketing PSUs (OMCs) for other two products namely Petrol (MS) and Diesel (HSD) so that the consumers can be protected from the volatility in the crude prices which, in general, from the perspective of the consumers means a 'subsidy' (referred to as under-recoveries' in the media).

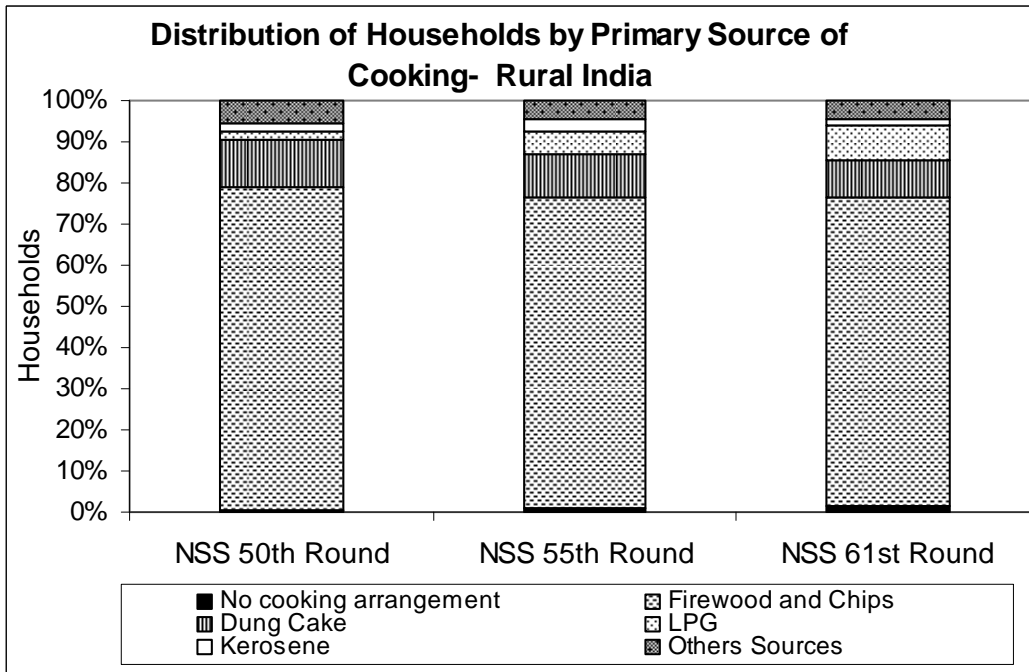
For FY 2008-09, the subsidy contribution of each of the four sensitive petroleum products namely, Domestic LPG, PDS Kerosene, Petrol and Diesel in the total subsidy amount of around Rs 105 thousand crores provided to oil sector are 18 per cent, 28 per cent, 5 per cent and 49 per cent respectively. Subsidy share for both Domestic LPG and PDS Kerosene in FY 2004-05 collectively accounted for around 90 per cent of total subsidies of the mentioned four sensitive products (Rs 22 thousand crores) given to oil sector has now been reduced by around 44 per cent. That reduction does not denote the steps by government towards subsidies reduction but it shows a response of the domestic market to divert huge part of subsidies meant for both of the products i.e. poor man's fuel- PDS Kerosene and urban middle class fuel- Domestic LPG to other two products- petrol and diesel.

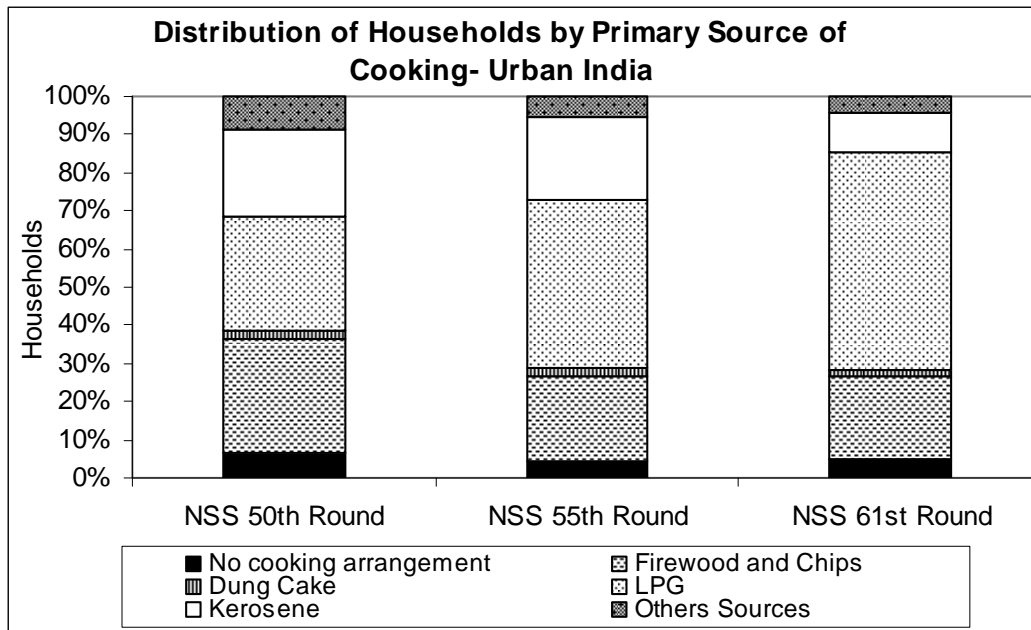
Trends in Subsidy Share of Petro-Products



Source: Petroleum Planning & Analysis Cell (PPAC).

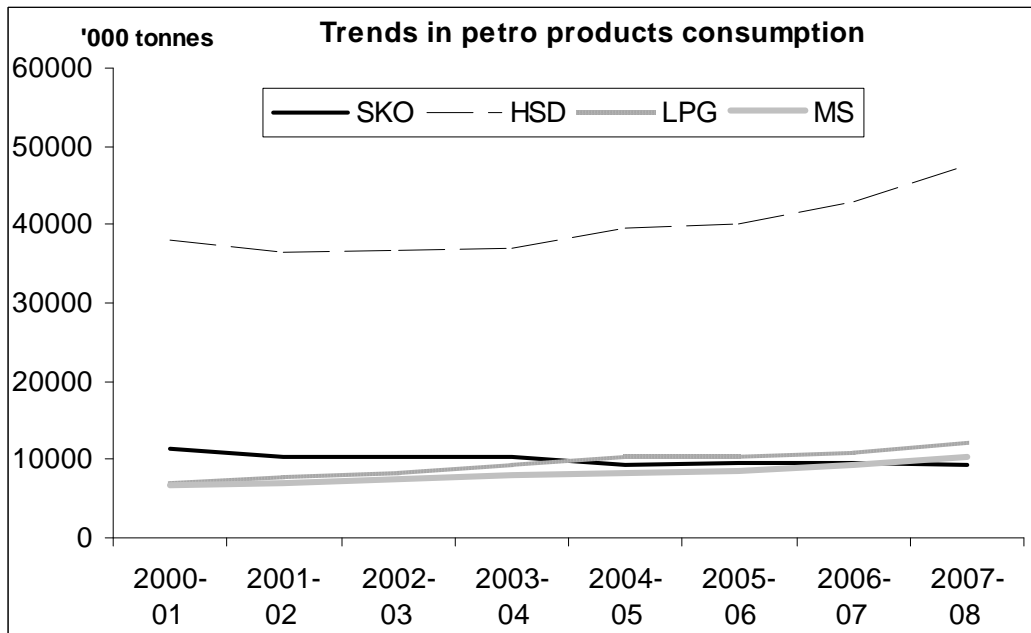
As per the NSS rounds (50th, 55th & 61st), while Kerosene use for cooking in Urban and Rural population has shown a declining tendency, LPG use for cooking has increased significantly. Secondly, the sales/consumption of Kerosene (PDS + free market) during these rounds remained stagnant. This shows that PDS Kerosene diverted to other purposes rather than being used as a poor man's fuel for cooking and lighting.





Source: NSSO (NSS 50th, 55th and 61st round), Ministry of Statistics and Programme Implementation.

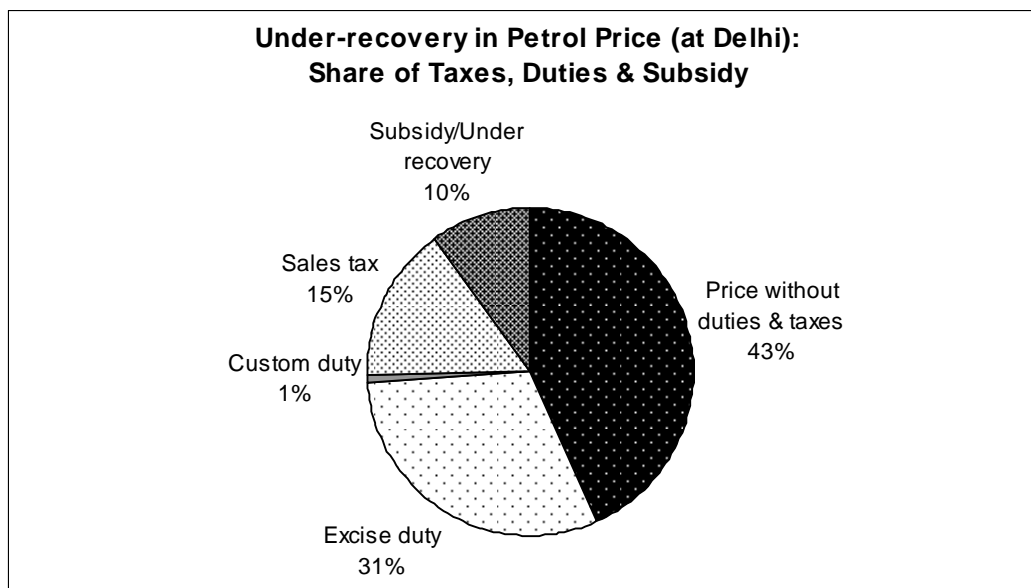
The diesel sales/consumption which were increasing in the range of 2 per cent to 6 per cent each year drastically increased in the last year (2007-08) i.e around 11 per cent. This is again a sign of diversion of this subsidized fuel, which is essentially supposed to be used by agriculture sector or truckers who transport essential goods, to other purposes. All this is due to the compatibility of these products in many common end uses with other petroleum products.



Source: Petroleum Planning & Analysis Cell.

Taxes

The other area of concern is the tax rate on these four petroleum products. Today, there are very miniscule taxes (like Vat, Octroi etc.) or no taxes on Domestic LPG and PDS Kerosene while there are huge taxes on petrol and diesel. For e.g. share of subsidies & taxes/duties in retail price of petrol in Delhi (around Rs 50 per litre during year 2008 including 'under-recovery' of around Rs 5 per litre to OMCs) is given below



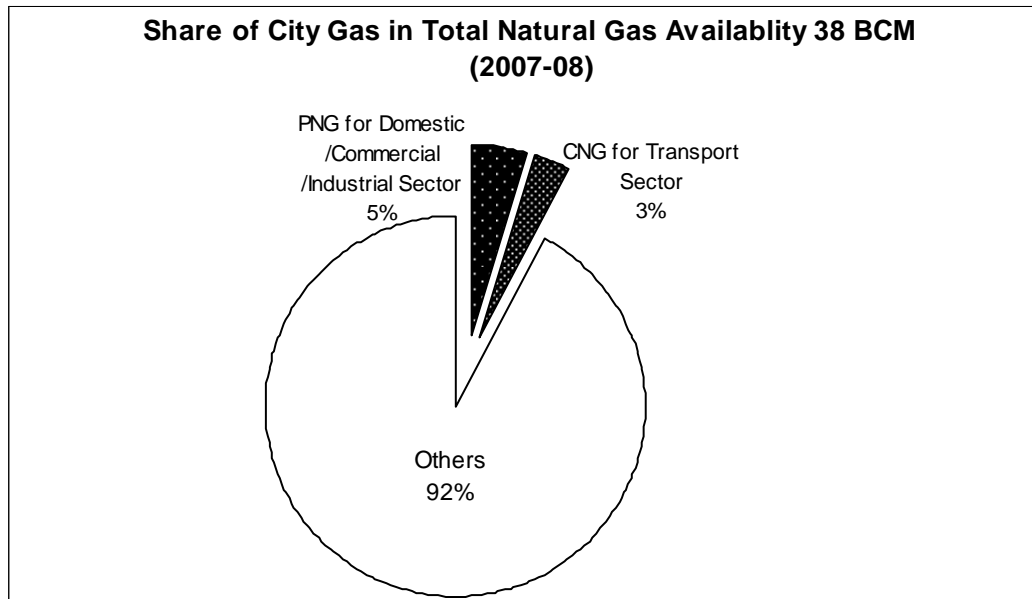
This implies that about 47 per cent is net tax payable on this particular product excluding the face value price (price without tax).

Therefore, today, due to short term ad-hoc measures (as described under heads-subsidies, taxes-above) of price control and taxation along with cross subsidization policies taken by the government to contain the price of these four petroleum products, the consumers, in reality, ended up to pay high prices for MS & HSD while at the same time consuming the low priced PDS Kerosene & LPG inefficiently with indulgence in adulteration.

Way-out

Although there is a big question mark on the physical 'availability' of natural gas, RIL's D-6 KG basin gas as well as finds of GSPC and ONGC, there is hope that supply will increase in the future. One way-out for Domestic LPG & PDS Kerosene subsidy phase out could be to implement City Gas Distribution (CGD) by choosing high population density areas which will offer greater economies of scale in cities in those states where CGD work is already going on. After providing Piped Natural Gas in a specific area in the chosen city, the LPG connections of the households living in that particular area could be surrendered. The same thing could also be done for PDS Kerosene at least for the cooking purposes at the initial stage.

Today, City Gas Distribution (CGD)- Compressed Natural Gas (CNG) for transport sector and Piped Natural Gas (PNG) for domestic, commercial & industrial sector- is already started in around 35 cities across India with around 15,000 kms pipeline network. The CNG sales which were around 70 million metric standard cubic meters (MMSCM) in 2000-01 grew by 15 times by 2007-08. In some of the developed economies, CGD share is in the range of 30-40 percent of their total gas consumption while in India it is around 8 per cent. This is almost the same share what natural gas shares (9%) in our primary commercial energy mix.



Source: PPAC and ICRA rating feature, July 2008.

As per media reports on the gas utilization policy, 5 MMSCMD has been allocated for CGD from RIL's D6 KG basin gas. This amount of gas is equivalent to around 1.5 million tonnes of oil equivalent. For FY 2007-08 our net oil import bill was around Rs 223 thousand crores for 104 million tonnes of oil. Using this allocated share of gas in CGD in transport sector it can not only reduce the carbon emissions but also our oil import bill by Rs 3,000 crores apart from reducing consumption of 1.5 million tonnes of oil (petrol & diesel). The reduced consumption of these dominant transportation fuels can again be a way-out to curtail the subsidies. This will also provide an economic option to consumers, since CNG vehicles have lower operational cost.

This scheme of replacing oil with natural gas can then be expanded to the rest of the country as the pipeline infrastructure catches up. Of course, this can happen more rapidly & efficiently only when the Government comes out with clear cut and transparent Gas Utilization Policy which remains a question mark.

Views are those of the author

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