IOSR Journal of Economics and Finance (IOSR-JEF)
e-ISSN: 2321-5933, p-ISSN: 2321-5925.Volume 4, Issue 6. (Jul-Aug. 2014), PP 31-35
www.iosrjournals.org

Escalating Petrol Prices in India: Repulsive Government Policies and Turbulence in Public

Dr. Shefali Dani
Director and Professor of Economics GLS Institute of Business Administration, Ahmedabad

Abstract: *This paper attempts to bring forward the reasons for soaring petrol prices in India. Crude oil is the most essential commodity and also the most traded product which influences an economy. Petroleum known as "liquid gold" and is compared to gold because it is an exhaustible resource and also of its economic value. The purpose of this study is 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 the government's pricing policy and absence compensation to oil companies. Thus, the government needs to extend subsidy to the targeted consumers in such a manner which does not impinge on the freedom of oil companies to set prices in the market place.*
Key words: *Indian Petroleum Industry, Hike in petrol prices, Government policies, Effect on general public*

I. Introduction

"India was the fourth-largest energy consumer in the world after China, the United States, and Russia in 2011, and despite having notable fossil fuel resources, the country has become increasingly dependent on energy imports" – US Energy Information Administration - June 26, 2014.

In any economy the energy sector plays an important role; the growth of the economy largely depends on the energy sector. There are many different sources of energy consumption, such as coal, crude oil, natural gas, hydroelectric, solar, wind, and nuclear energy. Out of India's total energy consumption, crude oil accounts for 24 per cent, natural gas 6 per cent, coal 40 per cent, combustible renewable and waste 27 per cent, hydroelectric power 2 per cent, and nuclear energy and wind energy about 1 per cent each; solar energy has an insignificant share (International Energy Agency , 2008).

The Indian petroleum industry dates back to 1890 when oil was first struck at Digboi in northeastern India. Oil exploration and production activities were largely confined to the northeast until the 1970s when the most prolific and important Indian producing basin, Bombay High, was discovered. While the exploration and production sector remained under the state control until 1991, the Government policy now allows joint as well as private sector to participate in this sector.

In India, the history indicates that this sector was largely regulated by the government only. To a great extent this can be determined to be the cause of India's poor share in the world's oil and gas production and petroleum product consumption. Some of the biggest problems associated with the sector include excessive dependence on import of energy products and very little participation of private players in the sector (Sharma, 2012)**.** India was the fourth-largest energy consumer in the world after China, the United States, and Russia in 2011, and its need for energy supply continues to climb as a result of the country's dynamic economic growth and modernization over the past several years. India's economy has grown at an average annual rate of approximately 7% since 2000, and it proved relatively resilient following the 2008 global financial crisis.(India, 2014)

II. Background Of Indian Petroleum Industry

To go into brief history of the Indian Petroleum Industry, it is significant to note that until independence of the country, the petroleum industry was largely dominated by private entities. It was only after independence that the government took control of the sector. Moreover in 1970s when oil crisis hit the country, nationalization of international oil majors took place in the country. It was, after this that the Administered Price Mechanism (APM) was suggested by the Oil Coordination Committee. This mechanism was aimed to assure stabilization of petroleum prices across the country (Sharma, 2012). Moreover, through APM producers, refiners and marketers were compensated for operating costs and also procured a fair return on their assets.

After its initial success, the APM had to depart due to the growing international market and the slow growth of Indian economy. The oil industry is said to be the wheel of an economy and its strategic linkage with almost all

other sectors cannot be overlooked. The APM was scrapped off due to the changing oil policies of the gulf countries. On all occasions when the oil prices escalated, the world economy went into a zoom. In the deregulated system, the price rate is the one that floats with changes in global crude rates with producers' and retailers' margins added on and the government taxes added over it. Thus, administering oil prices on continuous basis was totally un-viable (FACTS Global Energy Asia Pacific Refinery Configuration and Construction, 2009).

Exceptionally high crude oil prices in the international market and an almost stagnant domestic crude oil production has caused a drain on country's foreign exchange reserves. The Government is committed to mitigating these challenges and has, in fact, met with accelerated domestic exploration through its New Exploration Licensing Policy (NELP) policy initiative. Some of the world class oil discoveries have recently been reported from blocks offered under the NELP regime. Five NELP rounds have resulted into 110 PSCs being signed and the Sixth round offering 55 exploration blocks is still underway. Besides augmenting domestic reserves, India has successfully ventured overseas to acquire oil and gas assets and entered into long-term Liquefied Natural Gas (LNG) contracts as measures for enhancing energy security (FACTS Global Energy Asia Pacific Refinery Configuration and Construction, 2009).

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 (bbl/d) in 2013 compared to less than 1 million bbl/d of total liquids production. EIA projects India's demand will more than double to 8.2 million bbl/d by 2040, while domestic production will remain relatively flat, hovering around 1 million bbl/d. The high degree of dependence on imported crude oil has led Indian energy companies to diversify their supply sources. To this end, Indian national oil companies (NOCs) have purchased equity stakes in overseas oil and gas fields in South America, Africa, Southeast Asia, and the Caspian Sea region to acquire reserves and production capability. However, the majority of imports continue to come from the Middle East, where Indian companies have little direct access to investment(India, 2014).

The latest slowdown in growth of emerging market countries and higher inflation levels, combined with domestic supply and infrastructure constraints, have reduced India's annual inflation-adjusted gross domestic product (GDP) growth from a high of 10.3% in 2010 to 4.4% in 2013, according to the International Monetary Fund (IMF). India was the third-largest economy in the world in 2013, as measured on a purchasing power parity basis. Risks to economic growth in India include high debt levels, infrastructure deficiencies, delays in structural reforms, and political polarization between the country's two largest political parties, the Indian National Congress and the Bharatiya Janata Party (Petroleum Planning and Analysis Cell (2009, 2010), Oil Prices and Taxes, 2010).

Despite having large coal reserves and a healthy growth in natural gas production over the past two decades, India is increasingly dependent on imported fossil fuels. In 2013, India's former petroleum and natural gas minister, Veerappa Moily, announced that his ministry would work on an action plan to make India energy independent by 2030 through increased fossil fuel production, development of resources such as coal bed methane and shale gas, foreign acquisitions by domestic Indian companies of upstream hydrocarbon reserves, reduced subsidies on motor fuels, and oil and natural gas pricing reforms. The 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 also looking to further develop and harness its various renewable energy sources. These actions would effectively increase India's energy supply and create more efficiency in energy consumption. India already began implementing oil and gas pricing reforms over the past two years to foster sustainable investment and help lower subsidy costs

- **Subsidies for petroleum products in India**

In FY 2012—2013, of the total subsidy for petroleum products of INR 1,610 billion (USD 25.76 billion), INR 396 billion (USD 6.3 billion or 25 per cent) was for LPG. The poorest 20 per cent of households received 1 per cent of this subsidy on LPG in rural areas and 8 per cent in urban areas. Subsidized LPG can be justified on the grounds of the necessity of clean cooking fuels for poor households who would otherwise cook with dirty bio-fuels like wood, agricultural waste and dung, which cause indoor air pollutions leading to respiratory diseases and eye infections. Indoor air pollution causes an estimated half a million premature deaths every year. However, by granting the LPG subsidy equally to all households, the policy also supports the purchase of LPG by wealthier households who could afford to pay market prices.(India Energy Subsidy Review , 2014)

• **Progress is being made, but more needs to be done**

The government is concerned about subsidies on petroleum products and has taken measures to contain it. In late 2009 it set up an expert group to recommend "a viable and sustainable system of pricing petroleum products." In February 2010 the group recommended that petrol and diesel prices should be market-based at both the refinery gate and at the retail level. It also recommended that the subsidy on LPG and kerosene be reduced until a system (based on a unique identification card) to deliver the subsidy to the poor is implemented (Ministry of Petroleum and Natural Gas, 2010). Petrol prices were deregulated in July 2010. As a result, the price of petrol has increased from INR 44.72/litre (USD 0.71/litre) in January 2010 in Delhi to around INR 75/litre (USD 1.2/litre). The price of diesel has been raised periodically: by INR 5/litre (USD 0.08/litre) in June 2010, INR 4/litre (USD 0.06/litre) in August 2012, and there have been 11 monthly increases of INR 0.45/litre (USD 0.007/litre) since January 2013. However, depreciation of the Indian rupee and the increase in world crude prices, has slowed the fall in diesel under recoveries. They were INR 9/litre (USD 0.14/litre) in late 2013, compared to approximately INR 13/litre (USD 0.2/litre) in January 2010 (India Energy Subsidy Review , 2014)**.**

EXCESSIVE RISE IN OIL PRICES- GOVERNMENT POLICIES AND PUBLIC HAVOC.

There has been outrage among the general public about the price hike of petrol. The common man already burdened with inflationary pressures, increased petrol prices will further shrunk the real household incomes. There have been strong reactions from the opposing political parties as well as sharp reactions from the general public against the price rise.

The main reason behind increase in the 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 the depreciation is the ongoing euro crisis. Many institutional investors have moved out their investments in euro to dollar as dollar is considered to be safe haven. In order to be safe, some investment has also moved out of India. But the euro crisis only cannot justify the free fall of rupee. If we see the other currencies like Pound, Yen, Brazilian Real, there has been no significant depreciation, in fact yen has gained against dollar considering one year time frame. So what are the other significant reasons for depreciating rupee. One of prime reasons is our burgeoning fiscal deficit (difference between revenue and expenditure). The fiscal deficit for the year 2011-2012 stood at Rs 5,21,980 and it is targeted at Rs 5,13,590 crores for the 2012-2013. This huge deficit is primarily because of subsidy offered on food, fertilizer and petroleum. The oil subsidy for the year 2012-2013 is estimated to be Rs 43,580 crores. But we project the losses suffered by OMCs for the current year, this subsidy will come out to be Rs 1,14,000 crores.

According to twin deficit hypothesis, there is strong linkage between fiscal deficit and trade deficit (imports – exports). 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 the increased tax rates. Hence, people are left with more money, out which some of the 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 oil imports have to be paid in dollars, the importers need to buy dollars and sell rupee leading more demand of dollar and excess of rupee in the market. Considering the demand supply, rupee is continuously losing value; the OMCs have to shell out more rupee for same amount of oil imports.

Now if the prices of oil products are not increased, the deficit will keep on increasing further impacting our economy. An increase in price will result into fall in demand which means that fewer dollars will have to be paid for the oil imports, leading to lower trade deficit which will in turn lead to release of pressure on rupee-dollar rate.

Another effect of not increasing the prices oil products is that, government will need to compensate the OMCs for the subsidy offered. Government will finance this deficit by borrowing from the market leading crowding out of the private investment which will slow down our economic growth. It may lead to higher interest rates which will increase the common man's EMIs.

The prices of petrol have been increased. This will have some effect on trade deficit and rupee-dollar value but in order to have more pronounced effect, the government needs to increase the price of diesel, LPG and kerosene. An increase in prices of these will help government reduce its fiscal deficit, meaning less borrowing from the market leading to more funds available for the private investment. Hence better economic growth.

However, petrol hike directly or indirectly affects all the major sectors like transportation, textiles, auto, FMCG etc, for manufacturing & transportation. This affects the prices of daily essential commodities which are transported on a daily basis. Banking sector is also expected to suffer due to high inflation level. Increase in fuel price will also increase in food price. This will have a more 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 the transportation cost, increase in transportation cost will increase in price of goods, and this increase in price of goods would gradually force the people to loosen their pockets even more, and so on like this, the chain will further propagate. These ups and downs push more people into poverty and leading to a more pathetic situation of those already poor. This has obviously sent shock waves to the common man who is trying hard to make both ends meet. Price hike affects only the low wages or fixed salaried middle class families as compared to higher wages salaried class. The existing middle class is squeezed and many of those striving to attain the middle-class standard find it persistently out of remit will bring no negative impact on government employees as their DAs will be increase accordingly. Rich and corrupted people are least bothered of it. Business class like auto-rickshaw drivers shall transfer the burden to common people so they are also safe. Common people if doing business shall also pass the burden to customers and chain reactions. The community that suffers the most is the common people or "aam aadmi".

In the age of coalition politics, these are harsh decisions which the government may not be willing to take. But these decisions will have to be taken, to prevent our economy from stagnation. As the saying goes "Good economics is bad politics and vice versa", Mr Prime minister has to decide whether he is good at politics or good at economics.

WILL INDIA EMERGE AS A MAJOR GLOBAL REFINED PRODUCT EXPORTING HUB?

As set out in its 11th Five-Year Plan, the Government of India seeks to establish India as a global refined product exporting hub, both by instructing OMCs to take a more outward-oriented operating stance, and by encouraging private-sector refiners to invest in export-oriented refining capacity. This chapter will examine the extent to which India is likely to realize this internationally-significant policy and commercial goal in the medium-term (Clarke, 2010)

The measure of India's refined product export capacity over time will be the build-up of excess refinery capacity over domestic demand.43 In fact, India's actual refined product export volumes are likely to be larger than the aggregate of excess capacity. OMCs look to first supply the Indian market, and then to export the balance of refined product produced. Private-sector refiners, however, have no operational directive to first supply domestic markets. They will look to produce a product slate which optimizes total refining margins from period-to-period, and will sell to customers, irrespective of location, to allow this. Export markets are therefore not a "balance" option for private-sector refiners, but integral to their business model. There is thus the possibility of a situation in India of large exports of refined products in parallel with product imports to satisfy domestic demand. In the context of sectoral expansion to facilitate greater export potential, however, excess refinery capacity is nevertheless a valid measure of India's growing exporting potential (Report of the Expert Group on a Viable and Sustainable System of Pricing Petroleum Products, 2010).

The emergence of India as a global refined product exporting hub is likely to have significant implications for regional product markets, extending the depth of product markets in the Middle East and South-east Asia in particular. It is also likely to have competitive effects for established Asian refinery centers such as Japan, South Korea and Singapore, and even as far afield as the United States Gulf Coast, and North-Western Europe.44 Growing exports of refined product from India have the potential to add to the energy security of countries in the Middle East and Asia-Pacific that are increasingly reliant on refined product imports, such as Iran, Saudi Arabia, Vietnam, Indonesia and Australia. But, at the same time, they threaten to undermine competing (and often ageing) refineries in countries such as Japan, South Korea and Australia. This chapter looks primarily at the period to 2012, when the last of the current spate of refinery capacity additions in India will be completed. No large greenfield or brownfield refinery additions have been firmly proposed for start-up after 2012, given all projects finish to current project timelines. Several smaller expansion and upgrading projects are planned by RIL and each of India's OMCs to 2015. Given the lack of known firm investment plans, it is unlikely there would be any major capacity additions in India between 2012 and 2015, despite the breakneck speed in which Indian projects are completed. Further, it is difficult to anticipate policy settings for the period after 2012 – which impact directly on investment – until the release of the 12th Five-Year Plan in 2011. Analysis below therefore confines itself to the medium-term – focusing on the period to 2012, but also looking ahead to 2015. There is more data available on regional refinery capacity addition post-2012. For example, significant refining

capacity (over 2 mb/d) is scheduled to come on-line across the Middle East after 2014, particularly in Saudi Arabia, Kuwait and Iran (India Oil and Gas Report, Q3 , 2009)**.**

III. Conclusion

The situation is alarming. Petrol prices have been hiked and deregulation of diesel is just round the corner with domestic gas price hike waiting. All of this is bound to wreck havoc. With persistence calls for further disinvestment of public sector, OMCs are pouncing hard demanding more flesh and blood. And all this so that astronomical amount of capital they have accumulated could be invested and they could reap higher profits from it. That is the real story behind petrol price hike.

A viable and sustainable pricing system for petroleum products is a key requirement of stable, long-term growth of the economy. Similarly, a financially strong and globally competitive oil industry provides an enduring platform to strengthen energy security of the country. It is therefore important that oil companies should have the freedom to set prices based on competitive market conditions. The government needs to extend subsidy to the targeted consumers in such a manner which does not impinge on the freedom of oil companies to set prices in the market place.

References

[1]. (2014). India Energy Subsidy Review . Geneva: International Institute for Sustainable Development.
[2]. (2009). India Oil and Gas Report, Q3 . Business Monitor .
[3]. Clarke, K. (2010). India's Downstream Petroleum Sector . Paris: International Energy Agency .
[4]. (2009). FACTS Global Energy Asia Pacific Refinery Configuration and Construction. Oil Databook II.
[5]. (2014). India. US Energy Information Administration.
[6]. International Energy Agency . (2008). Retrieved 05 12, 2011, from World Energy Statistics, France: http://www.iea.org/ textbase/nppdf/free/2008/key_stats_2008.pdf /
[7]. (2010). Petroleum Planning and Analysis Cell (2009, 2010), Oil Prices and Taxes. Government of India.
[8]. (2010). Report of the Expert Group on a Viable and Sustainable System of Pricing Petroleum Products. Government of India, The Parikh Committee .
[9]. Sharma, S. (2012). Impact Of Government Policies On Competition In Indian Petroleum Industry. Delhi: Com petition Commission of india.
[10]. Sant, G. and S. Dixit (1996): 'Beneficiaries of IPS Subsidy and Impact of Tariff Hike', Economic and Political Weekly,31, 3315-3321.
[11]. Sriraman, S., Venkatesh, A., Karne, M., & Mohite, V. (2006). Competition issues in the road goods transport industry in India with special reference to the Mumbai Metropolitan Region. Retrieved from Competition Commission of India: http://www.competitioncommission.gov.in/Market_Studies_Research_Projects/CompletedStudies/ Link_of_Study1.pdf
[12]. Swain, A. K. (2006), "Political Economy of Public Policy Making in the Indian Electricity Sector: A Study of Orissa and Andhra Pradesh", M. Phil., Jawaharlal Nehru University.