

## Chapter - 15

### **PETROLEUM SUBSIDY: RIGHT OR WRONG?**

The petroleum subsidy that used to be a minor issue a few years back has now become a very vital issue that is capable of not only affecting the economy of the country but also the fate of the government in power. Though this issue is not associated with the traffic problems directly, it affects our fuel economy, environmental policies, automobile industries, transportation and the pocket of every commuter on the roads significantly. At present whatever knowledge we have about petroleum subsidy is mainly based on the information given by the government and oil companies. We should know this in a little more detail that would probably help us to make a correct decision about this. In this regard, here I am raising 11 relevant points in relation to petroleum subsidy, please go through these and decide yourself for an answer regarding the need for petroleum subsidy in our country.

**[I] Petroleum Subsidy: a discount or real loss?:** I would try to explain this with the following example. Suppose some garment company makes an item with a production cost of Rs 50 and keeps its selling price Rs 100 at its outlet. If due to some business policy the company sells these same items @ Rs 80 instead of Rs 100, then it would be called a discount of Rs 20 per item. The company does make profit [Rs 30], but not to the extent that it chose initially [Rs 50]. Now, if the similar item is sold @ for Rs 30, then it is an actual loss to the company amounting to Rs 20. Almost similar situations also exist with the various petroleum products.

At present [Dec. 2009] the production cost of petrol at the refinery level is around Rs 20 only and the proposed selling price including all taxes comes around Rs 49. The government is obliging us by giving a relief of Rs 4 in the form that instead of charging Rs 49 it is charging Rs 45 per litre. Now you can very well understand that this so-called 'relief of Rs 4 in petrol price' is basically a discount and not a true loss to the government. Thus it is the various central and state taxes [that too at incremental rates] and other complex charges like freight equalization levy, cess, reduction charge, RPO factor, etc, that really make it costlier by 145%.

As for under recoveries in petrol or diesel, it basically fits in with the definition of discount where the profit is not as per the agency's [oil company or government] expectations but certainly the company is not in loss. Yes, as far as under recoveries of kerosene and LPG are concerned it probably belongs to losses or true subsidy. Despite the loss on LPG and kerosene, the profit earned on petrol and diesel causes a collective net profit to these agencies.

As common citizens, we frequently see that news related to petroleum pricing have a paradoxical messages, making the common man utterly confused. For example, on one hand, a few weeks before the proposed hike, there are news like 'Subsidies driving top oil companies bankrupt', 'Oil companies are bleeding and losing 'X' hundred crore Rupees per day due to subsidy', while on the other hand, we also read that 'Despite incurring heavy losses, India's oil companies are among the top profit-making companies of the country. The Oil and Natural Gas Corporation retained its position as the highest corporate taxpayer and paid Rs 9,557 crore on its profit for the financial year 2007-2008'.

Even in the days of the severe crisis when crude oil prices were at record high [April-June 2008] the ONGC earned a net profit of Rs 6,636 crore in three months despite paying for the subsidy for all petroleum products [i.e. domestic cooking gas[LPG], kerosene, petrol and diesel]. What does it mean to the people? When asked about the discrepancy in these statements, the company people frequently explain that this profit is actually not on petroleum products but on the sale of lubricants, etc. It is like some automobile company commenting on its profit that it is not on the sale of vehicles but on the sale of accessories.

Similarly, the story of the government, the second party that suffers similar so-called 'heavy losses' due to subsidy, is also very interesting. On one side, there is news or statements like 'petroleum subsidy bill has reached a staggering high and is severely affecting the government's budget', etc. Yet on the other hand, we see the news that government earned from taxes Rs 1,50,000 crore in the year 2006-7 [that was only Rs 40,000 crore in 2004]. This shows that in spite of the discount and so called subsidy the actual income of government is increasing. Since the consumption of petroleum products is increasing by 11% every year, revenue is also bound to increase.

These paradoxical and contradictory news items force us to believe that the two so-called big losers i.e. oil companies and government 'play' in such great sync not only to make a huge profit out of the oil industry but also play with the psyche of the common man to get his sympathy. The general public at large, which is not aware of the real situation, thinks

that whatever the government is doing is correct and justified. What a drama! In view of all this, the plea made by the government and oil companies regarding price hike is more like frustration that despite the oil industry being a very lucrative 'business' having vast potential of huge profit making, the two are not getting the profit up to their expectations.

**[II] Subsidy: a moral commitment of the government:** There is a question why we need subsidy and why it should continue?

In India, there is a great economic inequality. This subsidy is basically a temporary or interim measure to support the poor till the government is able to remove this disparity. This is almost similar to that of a reservation issue in our system where the government feels that a socially backward or underprivileged segment of the population needs a special consideration. So reservation in various jobs and education systems is nothing but the subsidy to a special social segment till such a period when the government removes the social inequality. It is an irony that still in 62 years neither the economic nor the social inequality could be reduced or removed in our country. So far as the issue of reservation is concerned, at present not a single political party has the courage to reduce the reservation quota, instead, all are trying hard to approach 100%. Then why does the government not want to continue the subsidy for petroleum when the basic reason or philosophy behind it is the same.

**[III] There is almost a direct link between petroleum prices and inflation:** A rise in a petroleum price affects right from the industrialist to the poor man on the road. The hike causes a disproportionate short as well as long-term cascading effect on all fronts and commodities. Surveys have proved that a hike of petroleum price by 4-5% can increase household budget of the common man by up to 23%. The fuel category carries a significant weightage [4.7%] in WPI. It is frequently seen when there is a rise in diesel cost by 10% the truck operators invariably increase the freight charges by 20%.

Hike in petroleum prices in June 2008 serves as a perfect example to explain this. Immediately within a week after hike in the petroleum prices, the inflation rate sharply increased to a record high of 11.05% of its 13 years duration. More importantly within a short period of one week a rise of inflation by 2.31% was also a record. That was much more than expected by the learned economists of the government who expected a rise only by 0.5 to 0.6%. In such cases even if the government reduces the price of the petroleum if permitted, the vast 'after effects' of the inflation rarely get reversed. This we observed in January 2009 when the fuel price was decreased [petrol by Rs 10 and diesel by Rs

5] but we did not notice any significant reduction in the prices of basic commodities. Here it is necessary to mention that in India we are using the Wholesale Price Index [WPI] while most developed countries are using a more sensitive index i.e. Consumer Price Index (CPI) to calculate inflation. It is observed that the actual inflation as per CPI [i.e. retail price of commodities at your nearby grocery shop], is 4-5 times more than the government figures of inflation rate. This contrast between these two indices of inflation i.e. Wholesale Price Index and Retail Price Index was also very much evident in July 2009 when the petroleum prices were hiked. At this time the WPI was minus 1.5 while the RPI was above 8 showing how misleading the WPI is.

The government ultimately has to choose one out of the two measures to help the poor viz: providing subsidy on the petroleum or taking measures against inflation and other extensive after-effects caused by withdrawal of subsidy. I believe the former is better. However, the government avoids choosing the former option because the brunt of subsidy has to be borne by the government itself while in case of choosing the latter option the brunt is borne by the poor of the country and is not a headache of the government in power.

I think that those learned economists in the Finance Ministry who do not favour subsidy should seriously analyze each and every aspect of subsidy honestly with short as well as long-term implications before coming to a decision. There is a class among the modern economists who believe more in the growth rate of the country than its inflation rate. They feel now that the Indian economy is growing fast, so why worry about the rise in the inflation rate. I don't know what this so-called 'record above 9% growth rate' really means to the poor who are using kerosene for lighting a hut or a domestic help using city bus to commute. For them it is more important to know whether this '9% plus' growth rate is really improving their standards of living and lifting them above the poverty line or not. I believe out of the two i.e. growth rate and the inflation rate, it is the faster inflation rate that affects much more adversely the common man and creates more economic instability in our system as compared to a slower growth rate of the country. I also believe that a faster growth rate mainly helps the people of higher economic strata while a low inflation rate benefits people of all economic strata.

**[IV] Why such a hue and cry for a small amount of subsidy?:**

The issue of petroleum subsidy is probably being disproportionately exaggerated. Out of the total subsidies only 4% belongs to petroleum while the bulk of the subsidy [87%] goes to food and fertilizers. Petroleum subsidy at present is well below the 1% of the GDP and presently even

the total amount of all subsidies is less than 2% of our GDP. Furthermore, this total Indian subsidy is lesser even from average subsidy of the whole world [that is around 4% of the GDP] including the most developed countries. Then why are the learned economists so much against the subsidy business in India.

**[VII] Is the reason for 'Misuse of subsidy' adequate to discontinue it?:** Besides economic burden to the government, the misuse of the petroleum subsidy is another strong point that is against subsidy. Let us examine whether there is any other variety of subsidy that is not being misused to lesser or greater degree. Regarding fertilizers subsidy, all farmers who are using fertilizers are not genuinely poor. It is a fact that rich farmers are benefited most as they purchase in bulk. In some North Indian States farmers are millionaires and have been maintaining a rich life style, having SUVs and all kinds of luxury items. Similarly, the major part of the highly subsidized food does not reach the genuinely poor man, waiting at the receiving end for the various reasons [sent to black market, the actual poor are not having ration cards, food get rotten and damaged, FCI has not been working in all states having relatively a more poor population, etc]. Thus both food and fertilizers subsidies that constitute 87% of the total bulk are also not fulfilling their duties. Does it mean the government should stop it; or should we stop providing food to the poor at cheaper rates?

If in a langar (food court) of a gurudwara or in any temple, if some well-to-do people also join to have free food, does it mean the organizers should stop this trend? Certainly not. Similarly, it is true that in the Reservation Policy for jobs and education for socially underprivileged class is also being misused by the rich ones of the same classes. I don't think that any government at present time has the courage to withdraw this reservation facility merely on this ground.

If we are unable to curb the misuse, then it is our system's fault and not of the poor at the receiving end who are struggling to meet their two ends. So instead of stopping it, we have to find ways to minimize the misuse of subsidy. Modern government economists and the policy-makers now strongly hold that time has come for 'no more free lunch'. Unfortunately, many of the critical decisions on Indian economy are taken on the basis of some international studies and surveys, by the economists who know India more by reading rather than by experiencing it in the countryside. As regards politicians, as a rule, only those who are NOT in power say that petroleum subsidy should continue.

**[VI] Why a huge tax for such an essential and useful commodity?:** Today the government uses petroleum as a cash cow. Why

are taxes on petroleum products levied heavily similar to things like alcohol? In India, the total government amount of taxes [52%] on petroleum products are the highest among most of the Asian and developed countries. What does it show? Does petroleum belong to some entertainment or luxury items? As for diesel, except for diesel-based cars and personal utility vehicles [that constitute about 2.5% of the total motorized vehicles] we don't see any misuse or luxury out of the diesel that is being used by trucks, buses, farmers, or trains. Similarly in regard to petrol, in about 87% vehicles that are being used, it belongs to two and three-wheeler categories. I think most of the owners of these vehicles belong to middle class and use it judiciously and are in need of subsidy. Of course, car owners, both petrol and diesel-based, are financially secure and certainly are not eligible for subsidy. Our approach should be 'how to keep them out from this subsidy' rather than making a general opinion that increasing the price by tax would discourage misuse.

Just for information: the three main sources of income to the government are petroleum, alcohol and VAT.

**[VII] Centre vs State issue:** Out of the total revenue collected under different names from petroleum products, Centre and State governments share 63% and 37% respectively. Petroleum is mainly an imported item; the States are neither producing nor importing it directly, so the states have no reason to tax it. Then why are they getting disproportionate or huge revenue out of it? If at all, tax is justified on petroleum, it is the Centre that has the sole right to it. Why don't State governments come clean on this issue? It is very interesting to see that all the criticism or the public wrath regarding the price hike goes to the Central Government while the State governments enjoy only the revenue with 0% criticism.

**[VIII] What about the 'forcefully-availed subsidies'?:** Every year the government fails to recover large amounts of money from various private and government persons under various services like electricity, telephones, housing, etc. In the Power Sector only, State governments lose Rs 27,000 crore every year that goes waste due to under recovery and theft. Besides, on various government officials and politicians large amounts of bills concerning electricity, telephones, rent of forcefully occupied government residences, etc, remain under recovered every year. Though on record it remains as pending, everybody knows that it is next to impossible to recover it. So I believe all this is nothing but a forcefully-availed subsidy. This amount is many times more than petroleum subsidy but does not seem to be a big issue for the Government or the Opposition or for the futuristic economists of our country. Seeing the callous and reluctant attitude of Indian government towards one of such problems, i.e. forceful pos-

session of the government residences by its officers and politicians, the Supreme Court has sharply commented that 'even God cannot help this country'.

**[IX] Why this subsidy pains government?:** In case of direct subsidies like petroleum, the government is directly paying a monetary benefit to the people of India, as if the currency and money are directly being transferred from the government's pocket into the public pocket. For example, to purchase one litre of petrol that costs Rs 49 to the government, you have to pay only Rs 45 as the remaining balance is contributed by the government. That looks very odd. On the other hand, there are many more areas in which the government also provides a financial help to the countrymen, like health, education, etc, which are nothing but an indirect form of subsidies. The only difference is that instead of giving the money directly, it provides certain facilities to the people at a cost lower than the actual one. Out of the several thousand crores rupees under these various schemes of indirect subsidies about 85% goes waste or does not reach the actually needy people. But we don't raise this issue of waste in such schemes in that proportion which we make for the loss or misuse of petroleum subsidy.

Collecting large revenue from the public as tax and again re-routing it in the form of indirect subsidy to the public has some economic relevance only when our system works honestly largely in the interest of the general public. It has been accepted that out of Rs 100 that is taxed from the common man, only Rs 15 reaches again to him through these indirect subsidies or services and remaining 85% siphoned off in corruption. While in case of the direct subsidy the reverse is true despite the fact that some of it may be utilized by the rich, most of the budget allotted is utilized by the public only. In the present system of governance, if the government could reduce the tax burden on common men that would help them more than providing some little help after taxing them heavily.

A huge bulk of tax remains significant only politically, as while distributing the same money through various indirect subsidies the government has another chance to show as if this money is being paid in its behalf. However, the fact is that this is the public money that is being returned back to them in the form of various plans or indirect subsidies. Secondly, the government officials and politicians find indirect subsidies more useful as money passes through many sieves, meaning hands, so that it is 'properly' filtered before it reaches the poor.

**[X] Need for more transparency in company's data:** There is enough evidence to believe that the figures of losses by oil companies

or the government are exaggerated and notional. They are calculated on the global price of petroleum product basis instead of actual production cost at refinery level. I read on May 23, 2008 [Before the hike on petroleum when crude oil prices were at record high of \$130/barrel] that oil companies are losing Rs 600 crore per day. Then after the steepest hike in petroleum price by the government with simultaneous drop in oil price from \$130 to \$120, again on Aug. 9, 2008 I found that the combined loss of oil companies is still Rs 600 crore. I wonder how this data could be manufactured.

The companies cleverly include in subsidy many such expenses as are not paid in actuality. For an example it also includes all the expenses of the concerned departments and ministry of petroleum, including salary, bonus, etc. of all staff right from peons to seniormost officers. It is not less than a few thousand crore. So the balance-sheet of oil companies should also be scrutinized by some independent agency for the bogus expenses. With the help of these exaggerated figures, oil companies start making pressure and try to earn sympathy of the public and media.

**[XI] Government is refractory to lower the price when situation permits:** The companies and the government which do not lose any opportunity to hike the price are equally reluctant in lowering the price when the conditions permit. For example in June 2008, when the price was raised, the cost of crude oil was \$119/barrel. When the cost of the crude oil dropped significantly, the government refused to lower its price making a plea that the break even point for the companies of 'zero loss' is around \$67/barrel. Anyway, when the crude oil price touched the point of \$67, it again refused to slash the price saying that now there is devaluation in the Rupee so the break even point has come down to \$57. Even at the time when the crude oil price touched the figure of \$55, the government categorically refused by making the plea that 'it has just touched the desired figure and let it be maintained for some time say 4-6 weeks, only then we can consider to slash its price. Another plea by the government in this regard was that the companies have just started making profit so let them earn some profit for some time so that they can wipe out the net losses that have been incurred in the first half of the year. "Reducing the price of petrol and diesel now will wipe away this golden opportunity" it maintained.

However, when the crude oil touched the figure of \$43 it became difficult for the government to ignore the public pressure and had to slash the prices. Since the declaration of slashing the price was made just before the parliamentary elections, one was compelled to think whether

it was a matter of coincidence or government tried to get a political advantage. We also observed that when the oil prices started going down from August 2008, the ATF [air turbine fuel] was reduced by around 60% while during the same period the petrol for surface transport was reduced only by around 20%. I don't know what does it signify! I can only say that in India to commute from one city to another, a number of people using the planes, trains and roads everyday is around 1 lakh, 1 crore and 6 crore respectively.

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**About the Author:** Dr. Sanjay Kulshrestha is a Senior Consultant Pediatric and Neonatal Surgeon working at Agra since 1991. He was the first to start a pediatric surgery unit and performed first successful operation of some major problems, like absent food pipe or separation of conjoint twins, etc. in this region. He has published several articles in reputed international journals. He has introduced four original operative techniques for the management of male as well as female anorectal malformations that have been acknowledged internationally. He has also presented his original work in various international conferences in France, Portugal and Ireland. Congenital Anomalies are more common in the poor class. Unfortunately, facilities of pediatric surgery are not available in the Agra region in any of the government hospitals. To help poor persons he has established a society called 'Society against Birth Defects in Children' which is working in this region for the treatment of poor babies born with some birth defects for the last 12 years. However, he concedes that at present this Society is not working to his satisfaction. It is helping the cases of birth defects mainly by acting as a conduit between rich fellows, local charitable organizations and the poor patients. Along with senior obstetricians of this region, he is also actively involved in a project to find out the cost effective antenatal screening programme for diagnosing and managing birth defects in high risk pregnant women.

Dr. Sanjay and his wife Dr. Meeta are deeply concerned with the present environmental problems and believe that everyone of us can play a role at an individual level to improve our environment. In their new house, they have designed a different kind of domestic water harvesting for reusing the domestic waste water for kitchen garden and the lawns. Besides, they have also installed a modified rainwater harvesting system that requires less cleaning and can store more water in case of heavy rains. They are using the solar energy for hot water and garden lights.

**About the Editor:** Pradeep Vijayakar is an Assistant Editor of the Times of India, serving them since 1974 after working for two years for Sportsweek. He was awarded The Times of India gold medal for standing first in the journalism class of Rajendra Prasad Institute of mass Communication in 1971. He has been an all-rounder covering some twenty different sports at the highest level, including five cricket World Cups and three World Billiards championships and World squash events. He has been a commentator for Doordarshan and Akashwani. An active cricketer and table tennis player he is a qualified cricket and squash coach. He was course owner of the writing and communications streams of the Times School of Journalism, 2009. He is president of the Mumbai Press Club and vice-president of the Sports Journalists Federation of India. He is married to Smita and has two daughters, Devashree and Maitreyi.