



# INDIA ENERGY SUBSIDY BRIEFING

A bimonthly review of developments in Indian energy subsidy policy and energy markets

## Highlights

- Diesel price reform and lower international crude prices have reversed the losses that downstream oil companies have historically incurred on the sale of diesel. However the Modi Government has yet to decide on whether to deregulate diesel prices entirely. Higher diesel prices have also affected the sales of diesel vehicles, which have fallen significantly as a result of the falling price differential between diesel and petrol.
- The Modi government has again deferred the decision on natural gas price reform until 15 November 2014. The government has cited the elections in the states of Haryana and Maharashtra as the reason for the delay.
- A new banking scheme has been announced which aims to create bank accounts for every household in India. The scheme is designed to boost the effectiveness of social protection measures and may soon encourage the direct (and more targeted) transfer of energy subsidy payments to household beneficiaries.

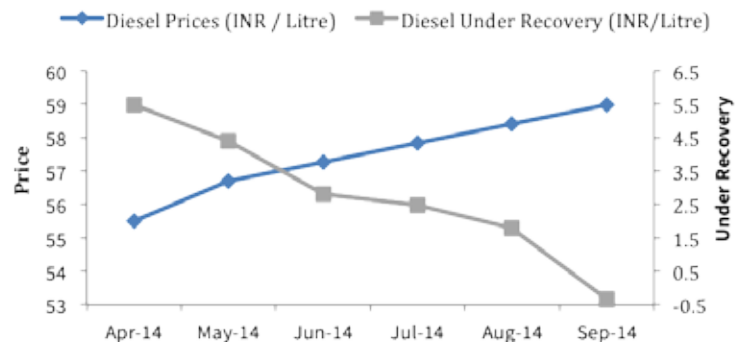
### Diesel

From 16 September, oil companies started making 'over-recoveries' of Rs0.35 per litre of diesel sold (Business Today, 2014). This has since deferred monthly diesel price increases (in defiance of an 18-month price appreciation trend) initiated by government in January 2013. Meanwhile, state-owned Oil Marketing Companies (OMCs) have been in the process of lobbying for a reduction in excise taxes on branded diesel to reduce the price differential between unbranded and branded diesel, however the request has been rejected by the central government (Airy, 2014). Currently diesel is retailed in two forms, unbranded diesel and a branded variant (which contains fuel additives for better mileage), with lower-grade diesel subject to lower excise rates (Zee News, 2014a).

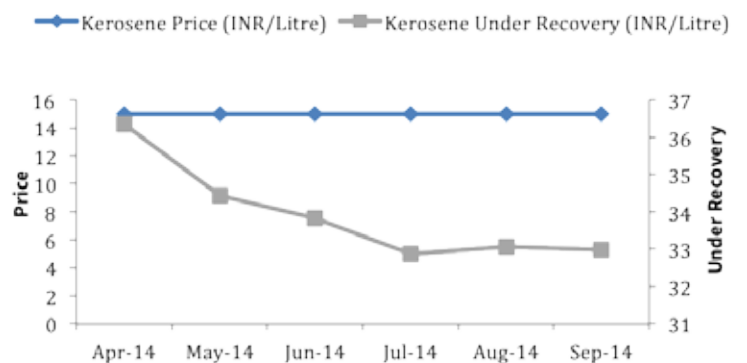
The percentage of diesel vehicles in India's passenger car fleet is expected to continue to fall as a result of the ongoing narrowing of price differentials between petrol and diesel, reversing the trend of 'dieselisation' that has taken place in recent years. Diesel car sales made up 15 per cent of passenger vehicles sales in 2007-08, increasing rapidly to 58 per cent by 2012-13. Since the beginning of diesel price appreciation in early-2013, this percentage has fallen to 53 per cent (in 2013-14) and is expected to fall further to 35 per cent in the coming two years (Khan, 2014).

In September 2014, Raghuram Rajan, Governor Reserve Bank of India, expressed support for the idea of complete diesel price liberalisation (as was achieved in gasoline markets in 2010). He said the current low in oil prices and in inflation was indication and opportunity for diesel prices to be deregulated (Zee News, 2014b). Cabinet, however, is only likely to decide whether to change diesel price-setting after the 15 October, 2014 state elections in Haryana and Maharashtra. Deregulation of diesel prices is likely to open opportunities for private sector retailers (such as Reliance and Essar) to re-enter the India fuel market, challenging the current oligopoly controlled by state-owned OMCs (Verma, 2014).

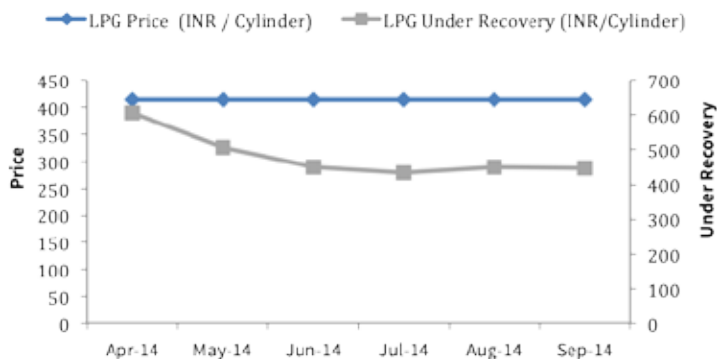
Diesel Price and Under Recovery



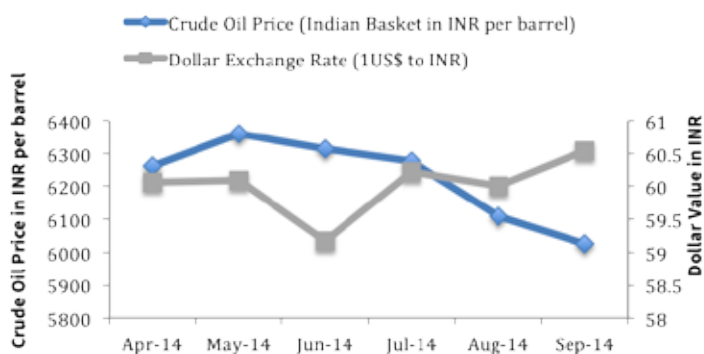
Kerosene Price and Under Recovery



### Subsidised LPG Price and Under Recovery



### Crude Oil Price and Dollar Value



Falling international crude prices have significantly eased the downward adjustment of diesel under-recoveries and, in turn, the adjustment of India's budget deficit. The budget deficit currently stands at 4.1 per cent of the GDP, which is also the government's target. With expenditure cuts in place and the savings from reduction in diesel under-recoveries likely to be ongoing, the Ministry of Finance expects the fiscal deficit could fall further in the coming months (Kumar, 2014a).

### Natural Gas Prices

The Modi Government has deferred hiking gas prices till 15 November, 2014 (Hindu BusinessLine, 2014). The government has been weighing the appropriateness of the gas price formula reforms proposed by the Rangarajan Report (released in 2012) which was originally planned to be put in place from April 2014 – and which was predicted to potentially double wholesale gas prices (Mehra & Verghese, 2014).

The Modi Government has set up a panel to review the Rangarajan formula, comprised of senior officials from the ministries of oil, power, finance and fertilizer. The report requires review from the Ministry of Petroleum and Natural Gas before any decision is announced, however it is anticipated that gas prices will rise by around 50 per cent from the current price of US\$4.2 mmBTU under the new regulations. For now, any decision on gas pricing has been deferred until after state elections in Haryana and Maharashtra, and most gas continues to be sold at \$4.2mmBTU (Economic Times, 2014) (Zee News, 2014).

Gas prices from 2019 will be determined by the newly submitted report by the Kelkar Committee. Vijay Kelkar, former finance and petroleum secretary, was asked by the previous government to set out a road map for the phased implementation of market-determined gas pricing. The report has not yet been released publicly but will likely recommend a move to market-determined prices from 2017 (Jayaswal, 2014).

Meanwhile, the Association of Oil and Gas Producers (AGP) have written to the Minister of Petroleum and Natural Gas, Dharmendra Pradhan, to lobby against the implementation of 'cost-plus' pricing of gas given the allocative inefficiencies involved in this form of price-setting. The AGP – comprised of upstream producers such as Reliance, ONGC, BP, Cairn, Essar and others – argues that in a cost plus regime, costs of failed explorations besides the cost of capital will be factored in to calculate the gas price while in a production sharing contract, the investor only benefits once a discovery has been made. The AGP has been strongly lobbying for an early transition to market-based pricing (Economic Times, 2014a).

### Electricity Subsidy

The government of Punjab plans to spend INR 49 billion (US \$ 810million) in 2014-15 on electricity subsidies. Most of this subsidy is passed on to agricultural consumers, however it is also comprised of 200 kWh per month of free electricity to certain minority households. The size of this subsidy has prompted the Union Finance Minister and the Power Minister to suggest rationalisation of subsidies to the state government (Mohan, 2014).

The Delhi state government, under the governorship of Najeeb Jung, has announced an electricity subsidy which will benefit 84 per cent of electricity consumers of Delhi. Under the electricity tariff schedule to be implemented, consumers will be charged Rs1.2 per kWh for consumption up to 200 kWh per month and Rs 0.8 per kWh for consumption between 200 to 400 kWh per month. Consumers have paying full-cost tariffs since 1 April when the subsidy program offered by the previous Delhi government lapsed (Times of India, 2014).

### Emerging Subsidy Distribution Schemes

A new banking scheme has been launched which aims to open a bank account for nearly every household in India. Under the scheme, account holders will receive a debit card, basic accident insurance up to the value of Rs.100,000 (US \$ 1,666) and some will also receive an overdraft facility. The scheme aims to provide the financial infrastructure to roll-out improved mechanism for the targeting of household assistance under various social welfare schemes (Kumar, Reuters, 2014).

The government is considering reintroducing the cash transfer scheme, DBTL (DBT for LPG) that was halted earlier in the year due to a variety of implementation challenges. The government has set up a panel comprising the Planning Commission and the UIDAI (the Unique Identification Authority India, which manages the ongoing implementation of the Aadhaar scheme) to review the program, its effectiveness and its likely impacts for households (The New Indian Express, 2014). However, no clear date has been announced to re-launch the scheme.

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