

**The invisible hand of self-interest:  
Corruption and politics of fuel subsidies**

**Presentation by  
Dr. Bhamy V. Shenoy at  
A seminar organized by  
Global Subsidy Initiative on  
The Hidden Costs of Fuel Subsidies in India  
At Mumbai YMCA, March 8, 2011**

# Political Economy of Subsidy Reform in India

## History of Petro-product subsidies

- 1939-1945: Subsidized kerosene included in Public Distribution System(PDS) for residential Consumers.
- Late 1960s: subsidies for liquified petroleum gas(LPG) introduced for res. consumers.
- 1976: Petroleum prices fixed under administrative price mechanism (APM)
- 1980s: First attempt at marking subsidized kerosene with dye.

# Political Economy of Subsidy Reform in India

## History of Petro-product subsidies

- 1989: Coupon system introduced to control access to subsidized kerosene in Mysore (program closed after two years).
- 2002: APM dismantled: Petroleum prices liberalized. But not kerosene and res. LPG.
- 2003: Government starts to control prices again.
- 2005: GPS fitted to kerosene distribution trucks to prevent diversion (closed in 2008)
- 2006: Adding a specialized dye to kerosene (program closed in 2008)

# Political Economy of Subsidy Reform in India

## History of Petro-product subsidies

- 2007: Planning commission recommends introduction of “high tech” smart cards to distribute residential kerosene. No state governments showed interest.
- Three high level committees to look at petro pricing
- 2006: Rangarajan committee recommends liberalization of petro product prices.
- 2008: Chutervedi committee also recommends liberalization of petro product prices.
- 2010: Parikh Committee recommends market oriented pricing. None of the committee reports were implemented till in July when gasoline was liberalized.

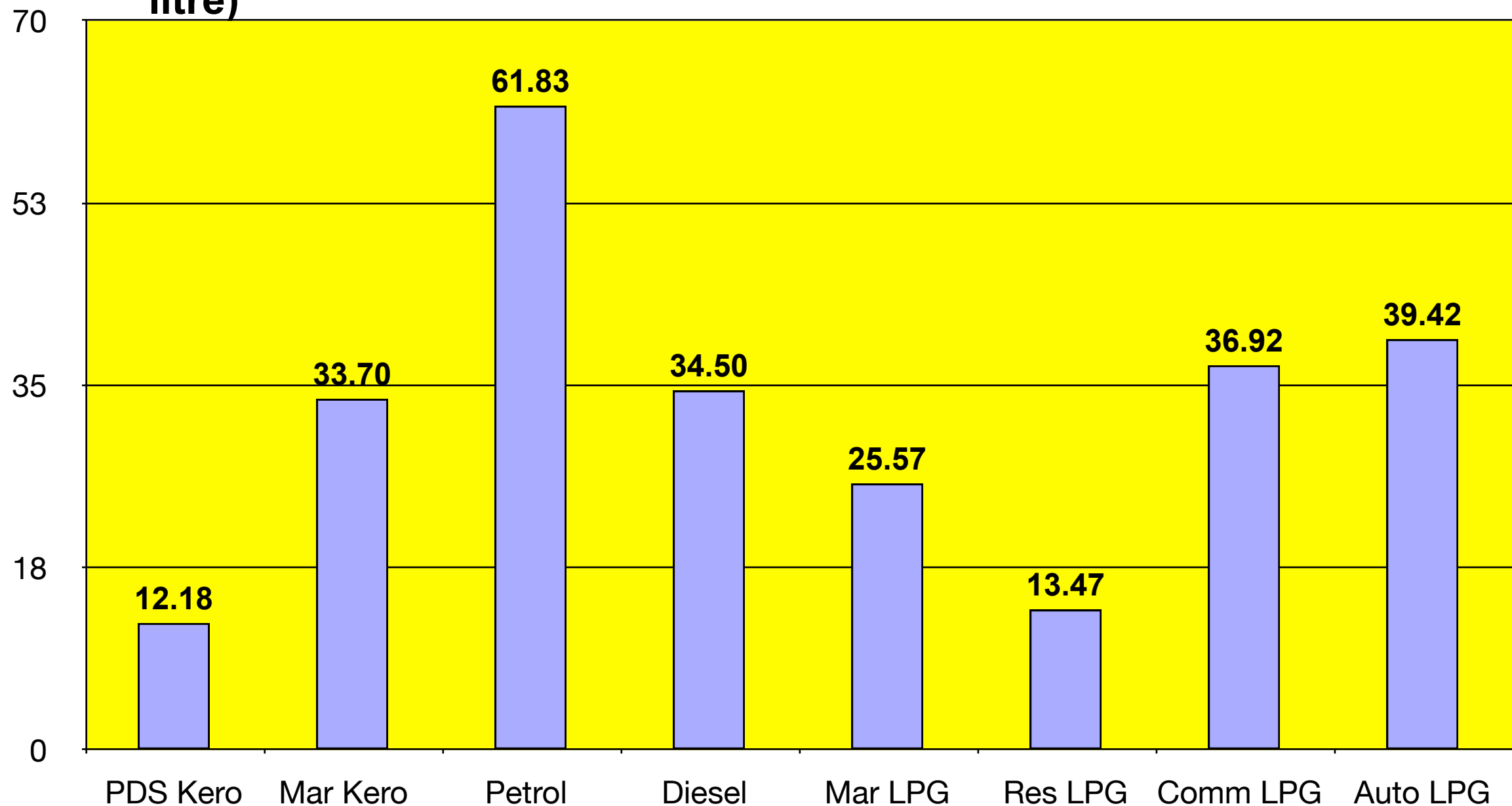
# Political Economy of Subsidy Reform in India

## History of Petro-product subsidies

- My research goes into the factors preventing any government to implement subsidy reforms despite the huge burden it imposes on the economy.
- India has been trying to reform subsidy regime through many innovative schemes, but the political system is preventing it.
- Three high level committees, several strategies like adding dyes, GPS to monitor trucks, coupon system, Smart card idea, Bio-metric Unique Identification Number etc.
- Every scheme has failed or not implemented. Why?  
It is Adam Smith's invisible hand of self interest

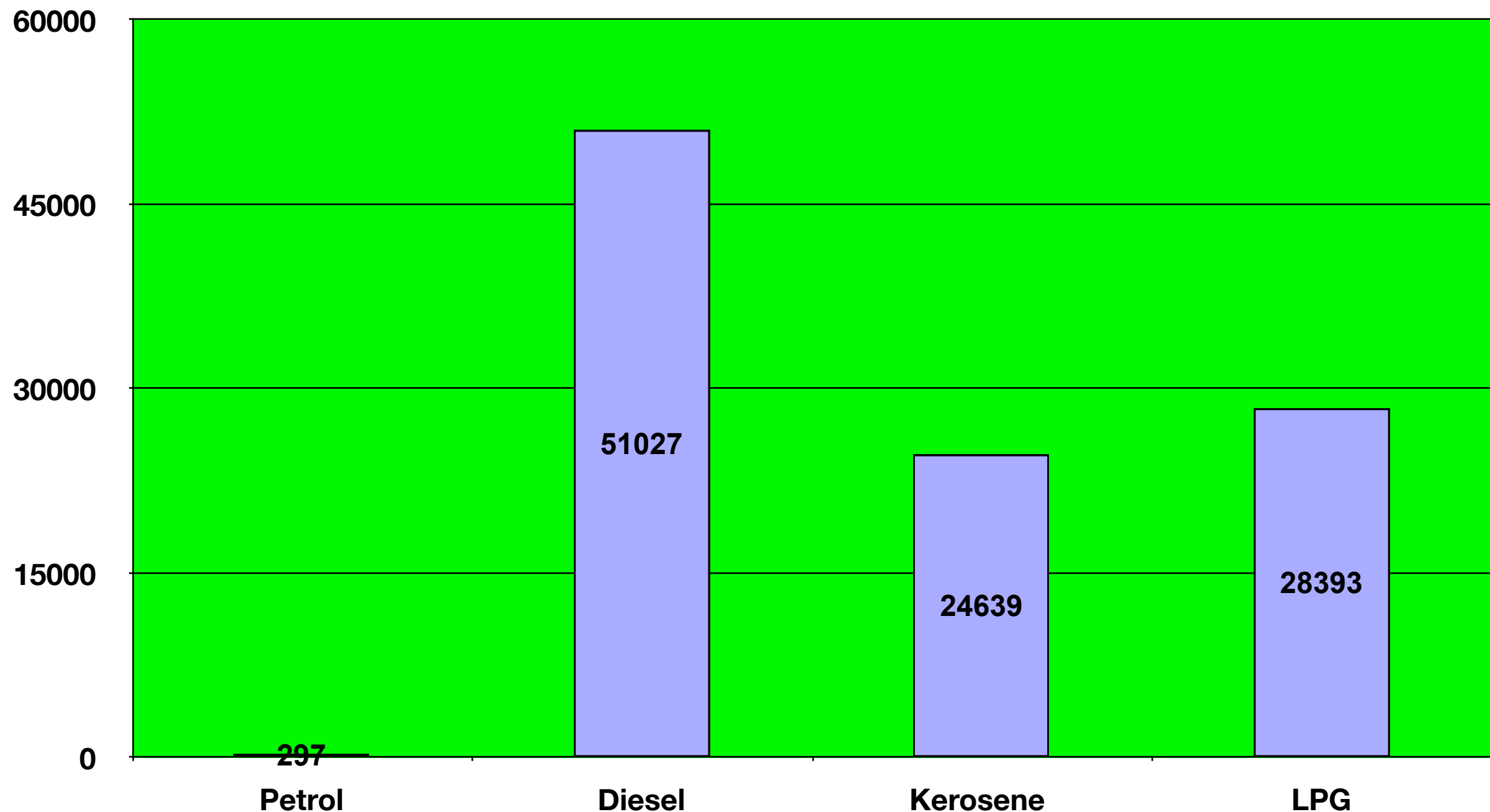
# The invisible hand of self-interest: Corruption and politics of fuel subsidies

Drivers behind adulteration and Diversion : Price differentials (Rs/  
litre)



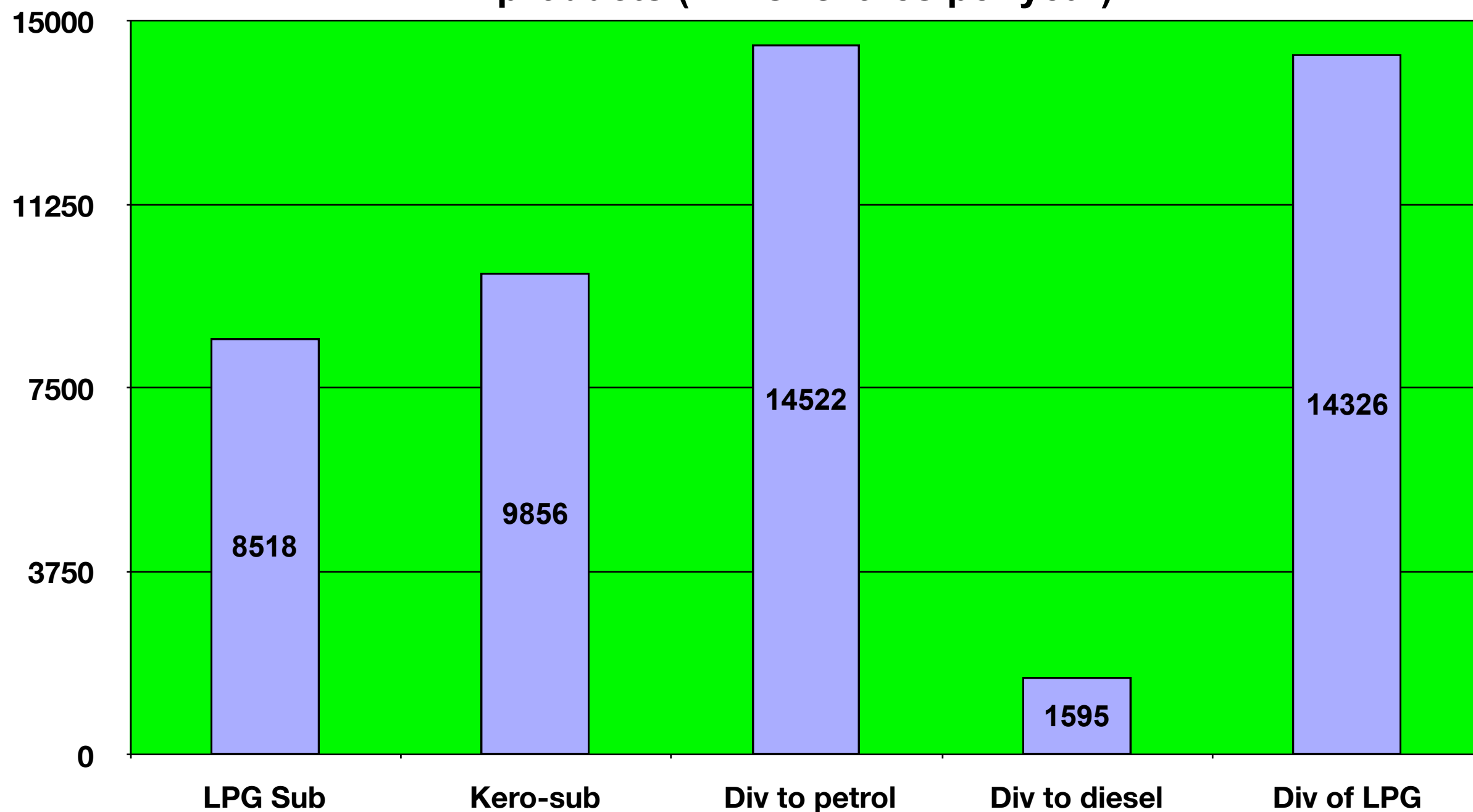
# The invisible hand of self-interest: Corruption and politics of fuel subsidies

## Petroleum Sector subsidies at \$100/b (Rs crores)



# The invisible hand of self-interest: Corruption and politics of fuel subsidies

Collection of rents from adulteration and diversion of subsidized products (in Rs. Crores per year)





# The invisible hand of self-interest: Corruption and politics of fuel subsidies

## Under recoveries by oil companies (Rs crores)

	2005-06	2006-07	2007-08	2008-09	2009-10
PDS Kerosene	14384	17883	19102	28225	17364
Residential LPG	10246	10701	15523	17600	14257
Gasoline	2723	2027	7322	5181	5151
Diesel	12647	18776	35166	52286	9279
Total Under-recoveries	<b>40000</b>	<b>49387</b>	<b>77123</b>	<b>103292</b>	<b>46051</b>

When crude oil price was \$147/b, under recoveries of oil companies were Rs. **250,000 crores**. This was 38% of total government revenues. Private companies were forced to close their 3000 service stations.

# The invisible hand of self-interest: Corruption and politics of fuel subsidies

## How were subsidies financed? (Rs. Crores)

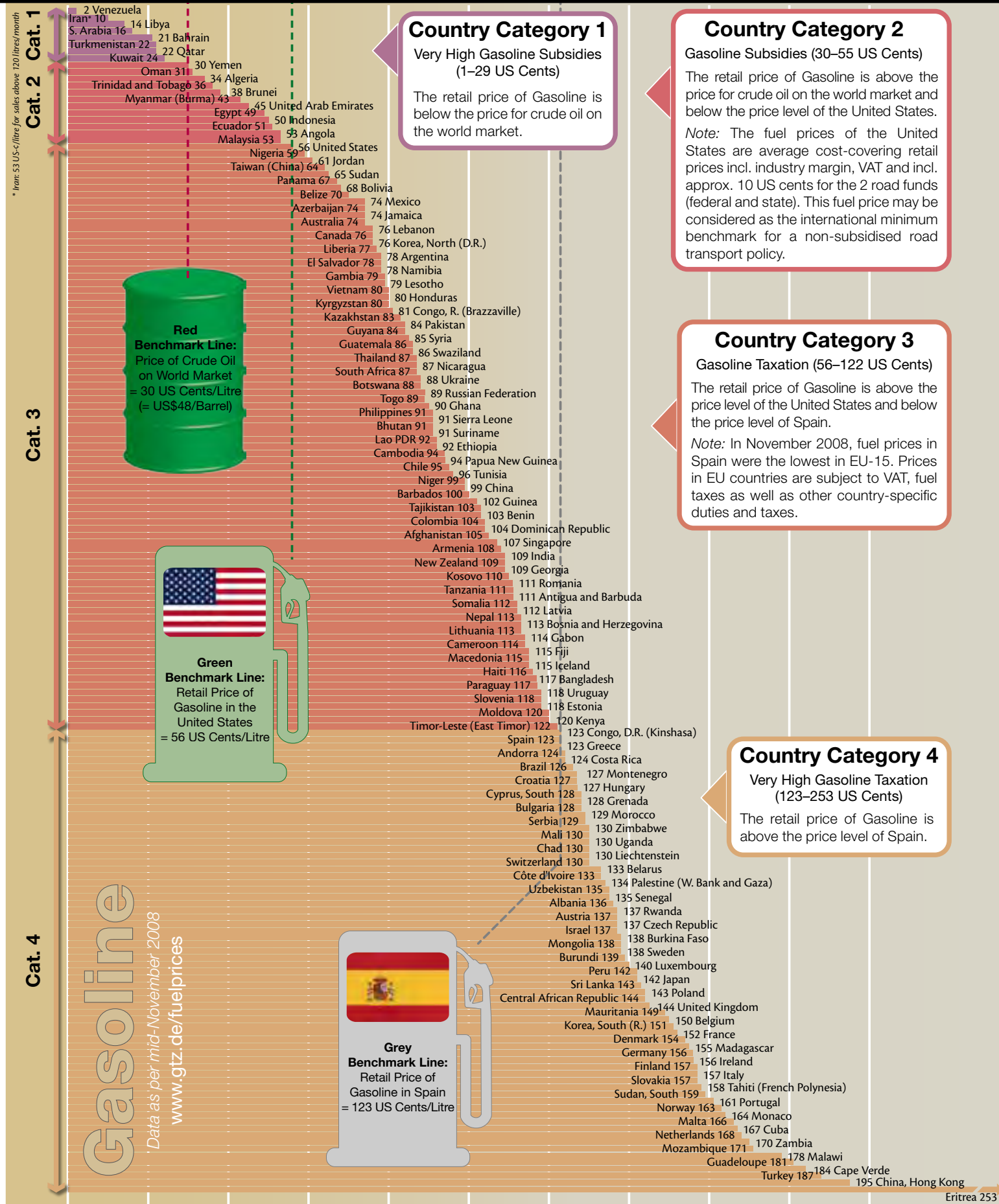
Type of Assistance	2004-05	2005-06	2006-07	2007-08
Transfer from Upstream	5947	14000	20507	25708
Central budget	2957	2930	3080	2822
Oil bonds	0	11500	24121	35290
total	8904	28430	47708	63820
Losses absorbed by marketing companies	NA	11570	1679	13303

# The invisible hand of self-interest: Corruption and politics of fuel subsidies

- Many question the estimates of under recoveries by OMCs. They feel it overstates the losses. Some also feel that the gov. can reduce prices by reducing taxes. If we go by international standards of taxing the downstream and also overall profitability of downstream, such arguments are not valid.

Petrol price build up	
	Rs/litre
Crude oil cost	28.31
Customs duty	1.46
Refining cost	0.77
Premium for petrol	3.80
Transportation cost	1.2
Marketing cost	1.1
customs duty (exc)	2.41
Excise taxes	14.35
Education cess	0.43
Sales taxes	12.37
total cost	63.79
Sales price	61.83
Profit/loss	-1.96

# Retail price of petrol in 174 countries as of Sep 2008



# The invisible hand of self-interest: Corruption and politics of fuel subsidies

- All political parties clamour for subsidies to help the poor. In reality most of the subsidies go into their pockets. The owner of this bullock cart is unable to earn subsistence living.





# The invisible hand of self-interest: Corruption and politics of fuel subsidies

- This is a regular sight seen in the morning in many urban areas where people wait for hours to get their kerosene quota. These are the people for whom political leaders pretend to shed crocodile tears.



## **The invisible hand of self-interest: Corruption and politics of fuel subsidies**

- Subsidies influence not only supply/demand for fossil fuels. It has impact on GHGs. We have been mostly concerning ourselves with economic impact of subsidy reform.
- In India and most likely in other developing countries, misused subsidies affect governance because of generation of black money on a large scale. It is this aspect of subsidy reform which has not got the attention which it deserves.

# The invisible hand of self-interest: Corruption and politics of fuel subsidies

- Manjunath, an IIM graduate was murdered by kerosene mafia in 2005. PM gave assurance that he would take steps to diversion of PDS kerosene. In 2010, an additional collector was murdered by kerosene mafia. Drowned in scams, his murder has been already gone off the national agenda.





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- In recent months when 2G scam, CWG scam, Adarsh scam have caught the imagination of the media and political class, why has petroleum scam involving PDS kerosene and residential LPG which is far larger been ignored? **Is it because the latter is systemic while in the former high visible leaders are involved?**



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## **RECOMMENDATIONS**

- In India we need greater publicity to the generation of black money through the misuse of fossil subsidies and the real beneficiaries of such subsidies. **Beneficiaries are not the poor as often claimed by politicians.**
- In comparison to many countries including some of the developing countries, India's tax rates are low.
- While assisting the poor is justified, we need to improve delivery system to improve governance.