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

Presentation by
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The Hidden Costs of Fuel Subsidies in India
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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.
### 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)
• 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.
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.
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Drivers behind adulteration and Diversion : Price differentials (Rs/litre)

- PDS Kero: 12.18
- Mar Kero: 33.70
- Petrol: 61.83
- Diesel: 34.50
- Mar LPG: 25.57
- Res LPG: 13.47
- Comm LPG: 36.92
- Auto LPG: 39.42
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Petroleum Sector subsidies at $100/b (Rs crores)
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Collection of rents from adulteration and diversion of subsidized products (in Rs. Crores per year)

- LPG Sub: 8518
- Kero-sub: 9856
- Div to petrol: 14522
- Div of LPG: 14326
- Div to diesel: 1595
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<table>
<thead>
<tr>
<th>Under recoveries by oil companies (Rs crores)</th>
<th>2005-06</th>
<th>2006-07</th>
<th>2007-08</th>
<th>2008-09</th>
<th>2009-10</th>
</tr>
</thead>
<tbody>
<tr>
<td>PDS Kerosene</td>
<td>14384</td>
<td>17883</td>
<td>19102</td>
<td>28225</td>
<td>17364</td>
</tr>
<tr>
<td>Residential LPG</td>
<td>10246</td>
<td>10701</td>
<td>15523</td>
<td>17600</td>
<td>14257</td>
</tr>
<tr>
<td>Gasoline</td>
<td>2723</td>
<td>2027</td>
<td>7322</td>
<td>5181</td>
<td>5151</td>
</tr>
<tr>
<td>Diesel</td>
<td>12647</td>
<td>18776</td>
<td>35166</td>
<td>52286</td>
<td>9279</td>
</tr>
<tr>
<td><strong>Total Under-recoveries</strong></td>
<td><strong>40000</strong></td>
<td><strong>49387</strong></td>
<td><strong>77123</strong></td>
<td><strong>103292</strong></td>
<td><strong>46051</strong></td>
</tr>
</tbody>
</table>

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.
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<table>
<thead>
<tr>
<th>Type of Assistance</th>
<th>2004-05</th>
<th>2005-06</th>
<th>2006-07</th>
<th>2007-08</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfer from Upstream</td>
<td>5947</td>
<td>14000</td>
<td>20507</td>
<td>25708</td>
</tr>
<tr>
<td>Central budget</td>
<td>2957</td>
<td>2930</td>
<td>3080</td>
<td>2822</td>
</tr>
<tr>
<td>Oil bonds</td>
<td>0</td>
<td>11500</td>
<td>24121</td>
<td>35290</td>
</tr>
<tr>
<td><strong>total</strong></td>
<td><strong>8904</strong></td>
<td><strong>28430</strong></td>
<td><strong>47708</strong></td>
<td><strong>63820</strong></td>
</tr>
<tr>
<td>Losses absorbed by marketing companies</td>
<td>NA</td>
<td>11570</td>
<td>1679</td>
<td>13303</td>
</tr>
</tbody>
</table>
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- Many questions 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.

<table>
<thead>
<tr>
<th>Petrol price build up</th>
<th>Rs/litre</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude oil cost</td>
<td>28.31</td>
</tr>
<tr>
<td>Customs duty</td>
<td>1.46</td>
</tr>
<tr>
<td>Refining cost</td>
<td>0.77</td>
</tr>
<tr>
<td>Premium for petrol</td>
<td>3.80</td>
</tr>
<tr>
<td>Transportation cost</td>
<td>1.2</td>
</tr>
<tr>
<td>Marketing cost</td>
<td>1.1</td>
</tr>
<tr>
<td>customs duty (exc)</td>
<td>2.41</td>
</tr>
<tr>
<td>Excise taxes</td>
<td>14.35</td>
</tr>
<tr>
<td>Education cess</td>
<td>0.43</td>
</tr>
<tr>
<td>Sales taxes</td>
<td>12.37</td>
</tr>
<tr>
<td>total cost</td>
<td>63.79</td>
</tr>
<tr>
<td>Sales price</td>
<td>61.83</td>
</tr>
<tr>
<td>Profit/loss</td>
<td>-1.96</td>
</tr>
</tbody>
</table>
Retail price of petrol in 174 countries as of Sep 2008

**Country Category 1**


The retail price of Gasoline is below the price for crude oil on the world market.

**Country Category 2**


The retail price of Gasoline is above the price for crude oil on the world market and below the price level of the United States.

Note: The fuel prices of the United States are average cost-covering retail prices incl. industry margin, VAT and incl. approx. 10 US cents for the 2 road funds (federal and state). This fuel price may be considered as the international minimum benchmark for a non-subsidised road transport policy.

**Country Category 3**

**Gasoline Taxation (56–122 US Cents)**

The retail price of Gasoline is above the price level of the United States and below the price level of Spain.

Note: In November 2008, fuel prices in Spain were the lowest in EU-15. Prices in EU countries are subject to VAT, fuel taxes as well as other country-specific duties and taxes.

**Country Category 4**

**Very High Gasoline Taxation (123–253 US Cents)**

The retail price of Gasoline is above the price level of Spain.
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.
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- 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.
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- 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.
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• 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.