Deregulating Diesel Prices*

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Fresh on the heels of the ruling party's election victories in the state assemblies of Maharashtra and Haryana, the NDA government has deregulated diesel prices and increased natural gas prices. The move is being presented as part of the government's "business-friendly" reforms, but the full implications have not been clearly or correctly interpreted by most media observers.

Consider the diesel price hike first. The move is being described as a bold move that will reduce the government's subsidy bill – but the truth is that the subsidy bill was already coming down, not because of any initiative of the government, but because global oil prices have fallen sharply. Global oil prices most recently peaked in early 2012, and since then the prices of Brent Crude, for example, have fallen by around 30 per cent, particularly over the past four months. The price for the basket of Indian oil imports has come down from an average of nearly $124 per barrel in March 2012 to less than $88 per barrel this month.

What this means is that – completely independent of any action by the government and within the framework of regulated diesel prices – Indian oil companies had already stopped making losses because of the decline in global prices relative to domestic prices. Indeed, losses were eliminated by the end of August, and the oil companies started making profits by mid-September. By mid-October, the profits of oil companies from diesel alone were estimated at Rs 3.56 per litre sold. This in turn obviously brings down the subsidy paid by government to cover the losses of public oil companies, which would have come down significantly and possibly even disappeared completely even if the government had decided to lower administered prices. So the argument that the deregulation of diesel prices was necessary to reduce the government's subsidy bill simply does not stand.

Indeed, given the low global prices, the deregulation just now will imply a decline in the Indian retail prices by about Rs 3.50 per litre. It is probably this feature that has emboldened the government to "seize this moment" as advised by RBI Governor Raghuram Rajan, since the deregulation will be (falsely) seen as providing the benefit of reduced prices and reduced subsidies rather than attributing these to global price trends.

The seeds of this strategy were clearly sown by the previous UPA government. In June 2010, it deregulated petrol prices, which have since then moved more or less in tandem with costs. Diesel prices were regulated, but not really to the benefit of consumers, since they were inevitably increased when global prices went up but the converse was rarely true, The last time diesel prices in India were lowered was more than five years ago, in January 2009. Since then, they have only been increased, and since January 2013 there have been monthly increases that amounted to a cumulative increase of nearly Rs 12 per litre, despite the downward trend of global prices. More cynically, the government – both UPA and NDA – have refused to adjust taxes (which are determined ad valorem and therefore increase with every increase in administered price) to provide some relief to consumers.

So what is wrong with deregulating the diesel price, if this indeed results in a decline in the retail price? Assessing it in this manner would be a very short term way of looking at the problem, and one that would not at all recognise the complex determination and implications of energy pricing that should concern any government concerned with medium term economic strategy. The point about deregulation is that henceforth the central government will no longer provide any subsidy on diesel, regardless of the level of the global price, and so the price will be linked to the market price. This may seem fine as long as global prices remain low (which is widely expected for the coming year since Saudi Arabia seems to be playing along with US interests in this regard by refusing to cut production) but matters will appear very different once global prices start rising again.

Diesel currently accounts for nearly half (around 43 per cent) of total fuel consumption in the country. It is absolutely critical for agricultural production and for transport of both goods and people. Diesel is as close to being a universal intermediate as we have, entering into the prices of almost all other goods and services. The government is indeed doubly lucky to experience a global price fall just now, which will also restrain domestic inflationary pressures. But that is a poor reason to allow this most essential price to be based entirely on the vagaries of global markets and the price decisions of domestic oligopolies.

In any case, the argument that both petrol and diesel in India should be determined by the global price has always been a peculiar one. Granted that these are traded goods – then why are all traded goods (or tradeable goods) not to be determined by world prices? The simple answer is because Indian wages and per capita incomes amount to only a fraction of global wages and incomes. In other words, you cannot have “global” prices for most traded goods in India simply because that would put them out of the reach of most of the population, since their wages or incomes are well below the global average. In terms of the relative prices of oil compared to wages, India already has among the highest retail oil prices in the world, many multiples of the relative oil prices experienced by consumers in, say, the United States of Europe.

In such a context, demanding that the price of an essential universal intermediate like oil should be determined by global market prices is simply another way of putting the squeeze on mass consumers, who are forced to pay higher prices for food and other necessities relative to their own incomes.

The other important economic decision was that relating to the natural gas price. This has been a bone of contention for some time now, especially after the extraordinary – and unwarranted – proposal of the Rangarajan Committee to set the price at almost double the prevailing price, based on extremely specious economic arguments. The government has not one for such a steep increase, but instead raised the price by around 46 per cent, from the current $4.2 per million British thermal unit to $ 6.17 per mBtu, to be effective from November 1. While not as extreme as the earlier proposal, this too is a significant hike. Finance Minister Arun Jaitley has reportedly said that the price will now be "sufficient incentive for drilling and investment" while at the same time it will "not excessively burden the consumers." But that is a moot point.

The gas price increase will result in CNG prices going up by Rs 4.25 per kg and piped cooking gas by Rs 2.6 per kg. The tariff for power produced from gas is estimated to go up by at least 90 paisa per unit and fertilizer production cost by almost Rs 2,720

per ton. Furthermore, the government has declared its intention to revise the gas price (presumably upwards) every six months, with the next revision planned for 1 April 2015. All this will definitely add to the costs of producing food and infrastructure costs in general.

These are inflationary pressures purposively introduced by government policy with the aim of satisfying large private investors like Reliance Industries, which is already under investigation for purportedly deliberately under producing from the gas fields it acquired from the public sector. The deceleration of inflation that has largely occurred because of slowing global prices is therefore being used by the government to enable policy shifts that cause certain prices to rise. Like all price changes, this is all about income distribution, and it encourages one more shift of income in favour of large capital at the expense of the mass of the population.

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