Subsidies, Oil Pricing, And the Aam Admi: Balancing Welfare and Economic Realities in India's Energy Sector

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Abstract

Despite being founded on the idea of achieving energy independence and self-sufficiency, India's oil sector has become a dysfunctional business over time due to subsidies. The Oil Marketing Companies, which were formerly seen as lucrative Public Sector Units (PSUs), are now having difficulty since they are seen as losing organisations. The concept of the aam admi (common man), however, is up for controversy despite the fact that the subsidy system was established with their interests in mind. The government's position on ending subsidies is ambiguous given that the term "poor" itself has political connotations.

INTRODUCTION

The Government of India is the largest stakeholder in the three main oil companies—Indian Oil Corporation Ltd., Hindustan Petroleum Corporation Ltd., and Bharat Petroleum Corporation Ltd.—which are primarily oil refining and marketing businesses. The term "OMCs" refers to the corporations that are listed on the stock market and stands for Oil Marketing corporations. Because crude oil was first found in the North East at Digboi in the late 19th century and still possesses some of the oldest operating oil wells in the world, India plays a significant role in the history of petroleum. However, in terms of this difference, we are, at best, on the edge of the global oil map. Similar to this, the three OMCs are only substantial in relation to India and are only medium-sized when compared to Asian oil corporations (Fortune Global 500 List 2012).

Following Independence, British-owned Burmah-Shell Oil Storage and Distributing Company of India Limited and American firms Standard-Vacuum Renewing Company of India Limited and Caltex Oil Renewing (India) Limited had a monopoly over a large portion of the nation's oil business. A committee with its headquarters in London oversaw the supply of petroleum products in India throughout the World Wars, and its chairman in that country was the general manager of Burmah-Shell (Dasgupta, 1971). Although the government's Industrial Policy Resolution of 1948 stated that national control of the oil sector would apply, the nation remained in fact reliant on a colonial supply chain. Oil could only be imported from nations who are part of the "UK Pound Sterling" region and not from nations that accept US dollars as a form of transaction. The Indian government asked the multinational (MNCs) oil companies for advice on a re-nery project in 1949 as a step towards achieving self-reliance. Citing significant financial losses that would be incurred in the project's operation, the MNCs advised against installing the re-nery. The MNCs would only agree to sell their goods at a price 10% over parity on the global market. As soon as oil was discovered in the Nahorkatiya oil field in 1953, the government rejected Burmah Oil's request to re-ne or sell the oil, which further strained ties.

Additionally, the government accused the corporations of charging high prices for imported oil, and the MNCs in turn refused to rene the government's purchases of Soviet oil at very advantageous prices. The remaining reneries in India were nationalised by the Indian government in 1958, which also established the Indian Reneries Ltd. Thus, state-owned businesses began to dominate the petroleum sector (Bakhshi, 2006; Dasgupta, 1971).

Factors Affecting the Price of Oil and Gas

One of the main forces propelling the expansion of the global economy has been the availability of oil and gas. Simply simply, there are nations that produce oil and those that consume it. A significant portion of the excess oil exported is only accessible in a few areas. Global oil prices are influenced by a number of variables, including supply and demand, trade speculation, the value of the US dollar, political unrest, geopolitical conflicts, and supplier cartel activity. Oil prices were adjusted for inflation for a very long time (between 1861 and 2010); in 2010, dollars were in the $10–30 range for all except around 35–40 years. Three time periods, from 1860 to 1861, 1979 to 1980, and 2007 to 2008, were distinguished by three significant price peaks (www.wtrg.com).

Other variables that affect oil prices include the US Federal Reserve's monetary policy since it increases demand for products and intensifies speculation the more money it generates. Consumers and manufacturers would become speculators and have strong inflationary expectations in the event of a declining currency. The location of the oil wells, as well as the distance and difficulty involved in transporting petroleum products to markets, are further significant factors. The import of petroleum products increased dramatically from 2.2 million tonnes in 1975 to over 18 million tonnes in 1995, despite the fact that India's use of these goods up to that point had mostly remained constant. The Administered Pricing Mechanism (APM), which was designed to protect the nation from international markets, is no longer relevant given the high levels of import. Additionally, it was predicted during the Ninth Plan Period that a sum of money in the region of Rs. 1,24,000 crores would be needed to build the infrastructure required to fulfil the nation's demand for petroleum products. It was acknowledged that neither the government nor the PSUs could make an investment of this size. It was deemed essential to include private funding from both local and foreign sources.

INDIA'S GLOBALISATION AND DEREGULATION

The Oil Industry Restructuring Group ('R' Group) was established by the Ministry of Petroleum and Natural Gas (MoP&NG) in 1995 to develop a time-bound plan for changes in the petroleum industry. An inter-ministerial Expert Technical Group (ETG) was also established to look at various scenarios revolving around the effects of various duty structure levels on various sectors. The government allowed FDI at 100% equity in the real estate industry, which was opened to international investment in 2000. The transition from the APM to the Market Determined Pricing Mechanism (MDPM) was planned by the government. The Government claimed the APM will be dismantled with effect from April 1, 2002, with the stated goal of achieving market-determined pricing for petroleum products. However, home LPG and PDS paraffin continued to receive subsidies since these fuels were mostly used by the "economically weaker sections of society." These at-rate subsidies were supposed to be phased off in three to five years. During this time, the Oil Marketing Companies (OMCs) were required to align the retail selling prices of these goods with global prices. The transition from an APM structure to an MDPM structure, however, never took place (Bandhyopadhay, 2010).The three OMCs' struggles are now well recognised. The "continued losses incurred by these companies" are mentioned in every piece, whether news or feature-related, about the petroleum sector. However, the resistance to liberalising the oil industry was intellectual as well as political. It could have been a cultural holdover from the time of the colonies. According to Rai (2010), there is an ingrained culture of mistrust towards foreigners, and the political economy of India, in which the oil and gas industry is enmeshed, is intricately linked to the sector. Any effort at deregulation was seen to just open the floodgates for private corporations to generate profits rather than gain from more effective marketing.

SUBSIDIES FOR OIL

The maintenance of subsidies is justified by a number of factors. The government artificially lowers prices to provide subsidies under the guise of welfare initiatives. The government encouraged OMCs to sell their goods below cost, and as a result, the government repaid 33 percent of the under recovery via subsidies and oil bonds, resulting in a confusing web of subsidies. According to Masilamani and Shiva Kumar (2010), there was a fairly pervasive belief that the government was overtaxing oil goods while attempting to create the impression that they were suffering losses. Due to strong resistance from both the privileged class and the political groups occupying the opposition benches, the government refrained from raising retail gasoline prices (Masilamani, 2010).The problems of the subsidy paradigm of development are fundamental. According to studies conducted in nations around the world, such as Colombia, Ghana, Indonesia, Malaysia, Turkey, and Zimbabwe (Einar, 1995), removing energy subsidies does not actually harm the poor, economic growth, or industrial competitiveness. Instead, it results in an increase in public revenues. Price hikes are advised to preserve financial resources and guarantee efficient use of resources when domestic energy prices fall below "opportunity" costs (World Bank Research Support Paper). Studies conducted in Mali (Kpodar and Kangni, 2006) reveal a U-shaped link between the influence of gasoline costs on family budgets and expenditures per capita. High-income families would not benefit disproportionately from oil price subsidies, regardless of the oil product taken into account. The impact of subsidy reform is often evenly spread across income categories, according to similar research in a few developing nations. For example, a $0.25 reduction in the per-litre subsidy led to a 6 percent drop in income for all classes. Due to significant benefit leakage to higher income groups, fuel subsidies are an expensive strategy for safeguarding the poor. According to Granados, Coady, David, and Gillingham (2010), the highest income quintile receives six times more subsidies in absolute terms than the lowest.

Subsidies: The Moral Imperative

Subsidies, however, were provided as incentives to the corporations as well as to the impoverished. According to Brownfield of Heritage Network (2011), tax loopholes are used to provide obligatory subsidies to oil and gas firms even in the United States. In the US, oil and gas firms may deduct an additional 6% of their taxable revenue as "intangible costs," or expenditures related to investing in oil exploration or production. Because royalties are considered taxes, the corporations are also allowed to deduct the royalties they pay to foreign governments. The annual worth of these subsidies to the oil sector in the United States is around $5 billion, while the business pays US$ 5.7 billion in federal income taxes on profits exceeding $30 billion. (2011) Becker and Posner. Subsidies to the U.S. oil and gas industry totaled $446.96 billion between 1994 and 2009 (Paul Nahi, Enphase Energy, Forbes, 2013).

When at them from a socioeconomic angle, subsidies are not totally bad. Activities that are not only motivated by profit must be funded by the government. From the perspective of social welfare, it should, nonetheless, result in the creation of advantages that would not have otherwise been realized. Given the equal importance of research and development to society and business, it makes reasonable to write off (deduct from taxable income) the costs associated with this endeavor. In the absence of subsidies, the margin structure is altered, hiding the actual cost of the product.

In India, the wealthiest tenth of earners receives from gasoline subsidies seven times more than the poorest tenth. There is a strong urban bias (International Monetary Fund, Working Paper, 2013). When deceptively low prices fail to fully account for expenses, it conveys the incorrect messages and encourages consumption over what is socially optimum. India imports over US$ 50 billion worth of petroleum annually to fulfill nearly three-quarters of its demands. Increasing consumption wastes money and drives up import costs.

The those who are unable to benefit from the subsidies bear the full weight of its opportunity cost. The subsidies that the poor receive—such as those for public transit, basic healthcare, and education—do not have the same resources accessible to them. Bonds issued to oil marketing corporations, which constitute a future obligation, are used to fund the subsidies. Better public transportation systems and other alternatives may be created more successfully if pricing were more in line with real costs. Since the average person often utilizes public transit, they would still benefit from the subsidies. (Dey, 2008)

In a nation that is utterly impoverished, subsidizing customers who are wealthy, middle-class, and low-income just does not make sense. The majority of citizens, according to the Arjun Sengupta

Committee (), make less than Rs. 20 per day. However, many automobile owners get implicit fuel subsidies of more than Rs. 100 each day. A price freeze on transportation fuels, according to many lawmakers, would shield the impoverished from inflation. In actuality, it mostly defends drivers, particularly those of sedans and high-end diesel vehicles. Elevated fuel prices may somewhat increase total prices due to transportation expenses, but the deficit finance needed to subsidize oil will also rise.

The oil subsidy lessens the incentive to move from private to public transportation and also serves as a subsidy for traffic jams and pollution on the streets. However, there is strong political opposition. People will acclimate to higher gasoline costs more quickly, and voters are more likely to forget about it (Swaminomics, 2008).

The average citizen does not even belong to the lowest income bracket; instead, they most likely fall into the "no income" group. It is crucial to know who the aam admi is in order to provide more clarification. Is it possible to assign a personality trait to the aam admi, often known as the "Common Man," who is the target of all government initiatives?

IDENTIFYING THE MISSING AAM ADMI

One of the main objections to a market-driven retail gasoline pricing regime, or an impenetrable rationale for subsidies, is that it impacts the "common man," or as the term "aam admi," to use a commonly used expression.

Let's examine certain socioeconomic classifications. Research that has financial backing is the greatest kind, particularly from individuals who sell goods and services. Advertising firms and marketers implement their best-laid plans based on the characterisations and assumptions provided by market research organizations. A new format for identifying India's population groups has been developed by the Market Research Users Council (MRUC, 2011) (http://www.mruc.net/new-demographic-map-of-India.pdf). The highest A1 socioeconomic classification (SEC), according to the MRUC classifications, accounts for 0.7 percent of the population, or 7–8 million individuals. At 33 million, or around 3% of the total population, the automobile category (if we can call it that) begins at A3. 11.4 percent of individuals, or around 140 million people, fall into the group of persons who exclusively possess two-wheelers. 42 percent of individuals fall into the SEC categories of E1, E2, and E3, which include 520 million people. Of them, 120 million people fall into the E3 category because they possess bicycles. However, interviews for media reports regarding price increases are often conducted at gas stations, when everyone from two-wheeler owners to those sitting in their automobiles laments, "The price is too high, how will the aam admi live?" Then there are the aam admi's political interpretations. According to a well-known interpretation made by a young politician with national acclaim, the aam aadmi is the individual who is disconnected from the system. An aam aadmi is someone who is not a part of the system, regardless of his wealth or poverty, religion (Hindu, Muslim, Sikh, or Christian), education level, or lack thereof. The term "aam aadmi" refers to the Dalit child in Jhansi who is compelled to sit at the back of the class, or the tribal lad in Nayamgiri who is expelled from his property without due process. He's the university top student in Shillong who can't find a job because he doesn't know the appropriate people, or she's the young professional from Bangalore who can't get her kid into a decent school. The aam aadmi is the businessman in Hyderabad who is passed over because he lacks the necessary connections, or the farmer in Aligarh who does not get the price he deserves for his property. The term "aam aadmi" refers to the widow in Vidarbha who is fighting to make ends meet in spite of tragedies in her family or the bureaucrat whose career is in jeopardy due to his uncompromising refusal to make concessions. He is the laborer who toils day and night to construct the Metro, never receiving recognition for his efforts, or he is the impoverished carpenter from a basti who lives in Mumbai's slums and was unable to pursue an education due to lack of opportunity. [Rediff News, 22 December 2010].

According to this understanding, everyone who is not a government employee is automatically considered an aam admi. The illusive aam admi is something of an illusion, taking on several forms based on the one dreaming of it.

Conclusion

The Indian oil sector has come a long way from the colonial times and is currently a complicated structure that comprises mostly of public sector companies which are incurring into subsides. These subsidies, originally designed as shield for the 'common man' have resulted in perverse incentives within the oil marketing companies (OMCs) and inefficiencies in the supply side. The so called aam admi has been at the core of the subsidy debate, but who is the aam admi and whether he is benefiting from the subsidies is still a matter of debate.

After the independence, Indian oil sector which was under the control of multinational companies changed its control in the state hand. This was in line with the plan to transform the country's source of energy so as to be more independent. However, this has greatly reached a point where these OMCs are now operating under the subsidy regime and that has reduced the profitability of these firms. Pricing has been used by the government by using tools such as Administered Pricing Mechanism (APM) and Market Determined Pricing Mechanism (MDPM) in a bid to control oil prices. Nonetheless, subsidies continue to be prevalent especially for products such as LPG and kerosene because the governments think of these as crucial for the lower income groups.

Several factors affect the international oil prices some of them include political instabilities, currency fluctuations and demand and supply. India especially is a major importer of oil and therefore any hike in the price of oil has a worse effect on its economy. Subsidies are meant to prevent ordinary people from being affected by such circumstance but unfortunately they favor higher end groups. For instance statistical data indicate that while the richest earners get more subsidies than the poorest quintile the system is expensive and does not reach the targeted beneficiaries efficiently.

The validity for subsidization does not just stop in the protection of the poor. At times they are employed to encourage specific undertakings by companies for instance through offering tax exemptions for drilling for oil. This leads to creation of many financial channels where the actual cost implication of energy consumption is not well shown. In addition, subsidies have negative impact on the environment since it encourages people to consume more and does not encourage people to adapt environmentally friendly ways of transport like the use of public transport.

It is not only an economic issue how subsidies are defined but it is also a political one. Opposition to the liberalizing of the oil sector options is from political parties and the populace which believed that increase in the prices of oil will only worsen the poverty levels in the country. But other studies conducted in other developing countries have shown that this process of elimination of subsidies also enhances the aspect of public revenues without any sign of negatively affecting the poor while at the same time increasing the efficient usage of resources.

As one would expect, this is a source of considerable controversy; and the biggest question that remains is that the term aam admi is nowhere clearly defined. On the political front, it has been applied to the rural farmer, the small peasantry, the urban workers, right to the social middle income group. Such blurriness complicates the process of policy formulation in a way that it becomes hard to identify and provide for the needy. In actuality, most of the fuel subsidies actually benefit car owners as well as inhabitants of urban areas rather than the targeted groups The essential meaning of subsidies in India's oil sector; promoted as welfare support for 'the common man,' is quite distorted and mostly enriches the upper classes and large enterprises. The current working structure leads to a lot of wastage the authorized funds and does not address the neediest individuals. Such problems can be avoided by employing a more selective strategy, perhaps through a more efficient subsidisation of extreme users or the gradual conversion to marginal cost pricing. To come out of the dependency on oil imports and to balance the energy consumption effectively the subsidy structure in India needs to be reformed. Removing or changing subsidies would not only yield better outcomes on the fiscal and budgetary front but also induce people of the world into adopting more sustainable energy resources and consumption profile.

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