Despite Cheaper Oil Imports, 'Seller's Inflation' Leading to High Retail Prices?

thequint.com/opinion/despite-cheaper-oil-imports-seller-inflation-leading-to-high-retail-prices

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Economist Isabella M Weber was recently listed in the Times100 list of most influential people.

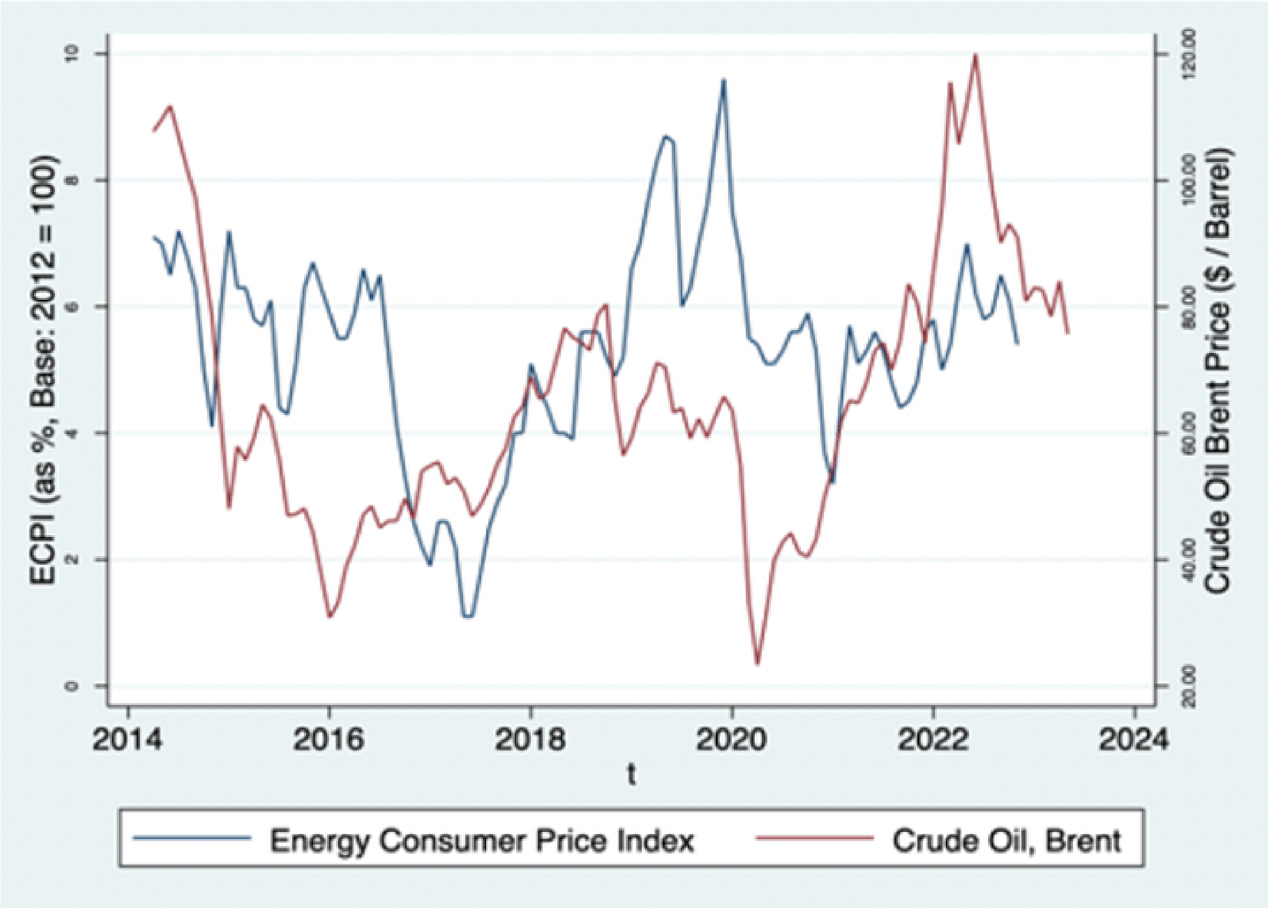
Her work, in the context of the US and the EU, explained what is being defined as seller’s inflation, where companies, particularly in oligopolistic market conditions (markets where few firms/corporate companies control the market share of a commodity), keep prices high to earn abnormal profits.

Greed underlines the motivation for artificially producing inflation, which acts as a tax on the most vulnerable and poor.

> When oil companies were making abnormal profits from volatile oil prices in Europe, one of the measures adopted by the EU was to impose a windfall profit tax to correct the abnormal rise of incomes enjoyed by such companies, and give relief to the consumers.

While energy prices reduced drastically since last year, the persistent effect of the inflationary pressures still hurt the common households of Europe.

Crude Oil Prices ($ per barrel)
20
40
60
80
100
120
2014
2016
2018
2020
2022
2024



While Europe was caught in the immediate crossfire of the growing geopolitical rivalry among major powers, the effects of a disrupted supply chain during the COVID years, exacerbated by the rising costs of transportation, meant rising prices of essential commodities.

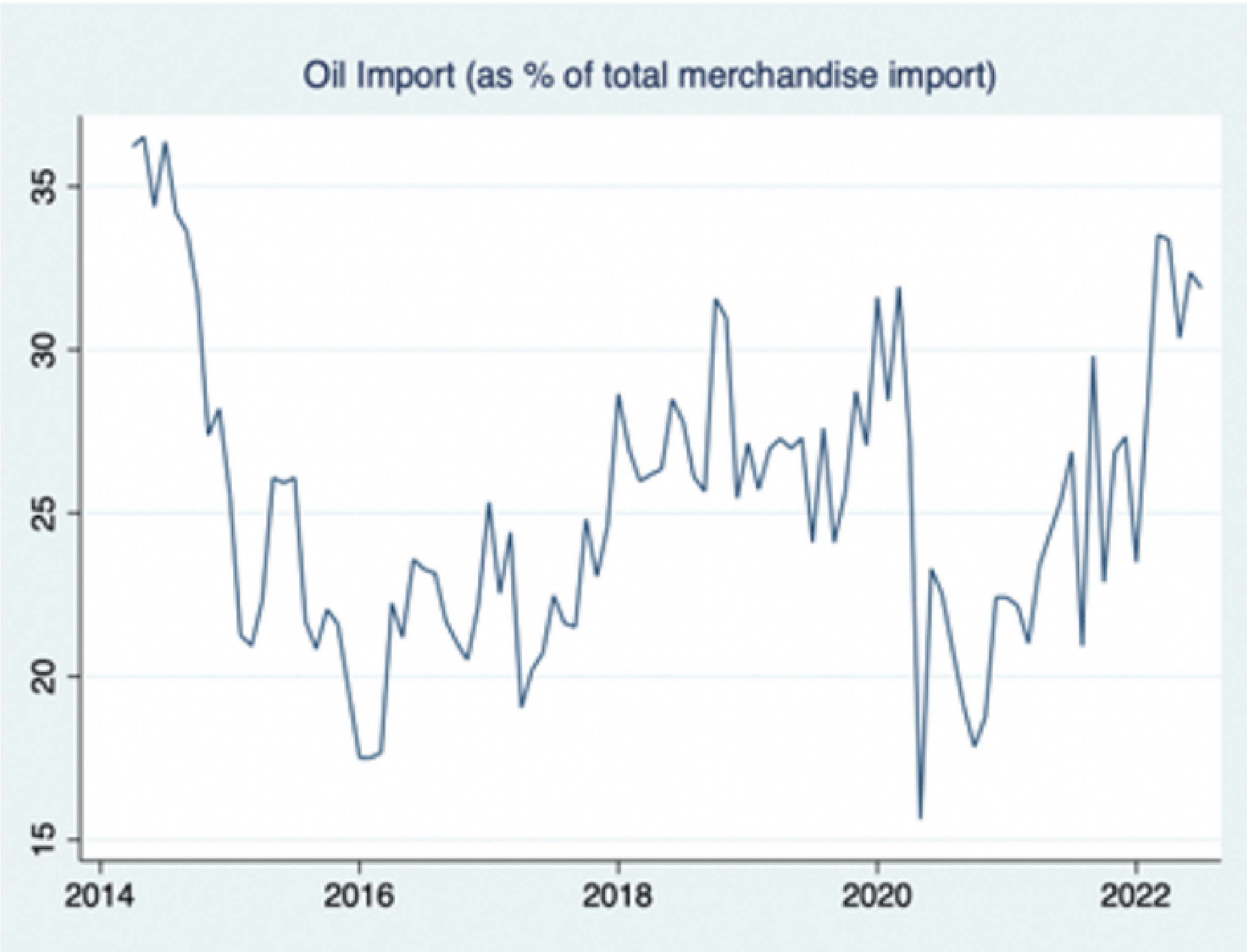
Russia and Ukraine have both been export-driven economies, with the former being a major energy supplier to the world. Food items such as wheat have also been exported from both countries, meeting 30 percent of the global demand, with countries in Asia and Africa fulfilling their food import requirement thanks to both countries.

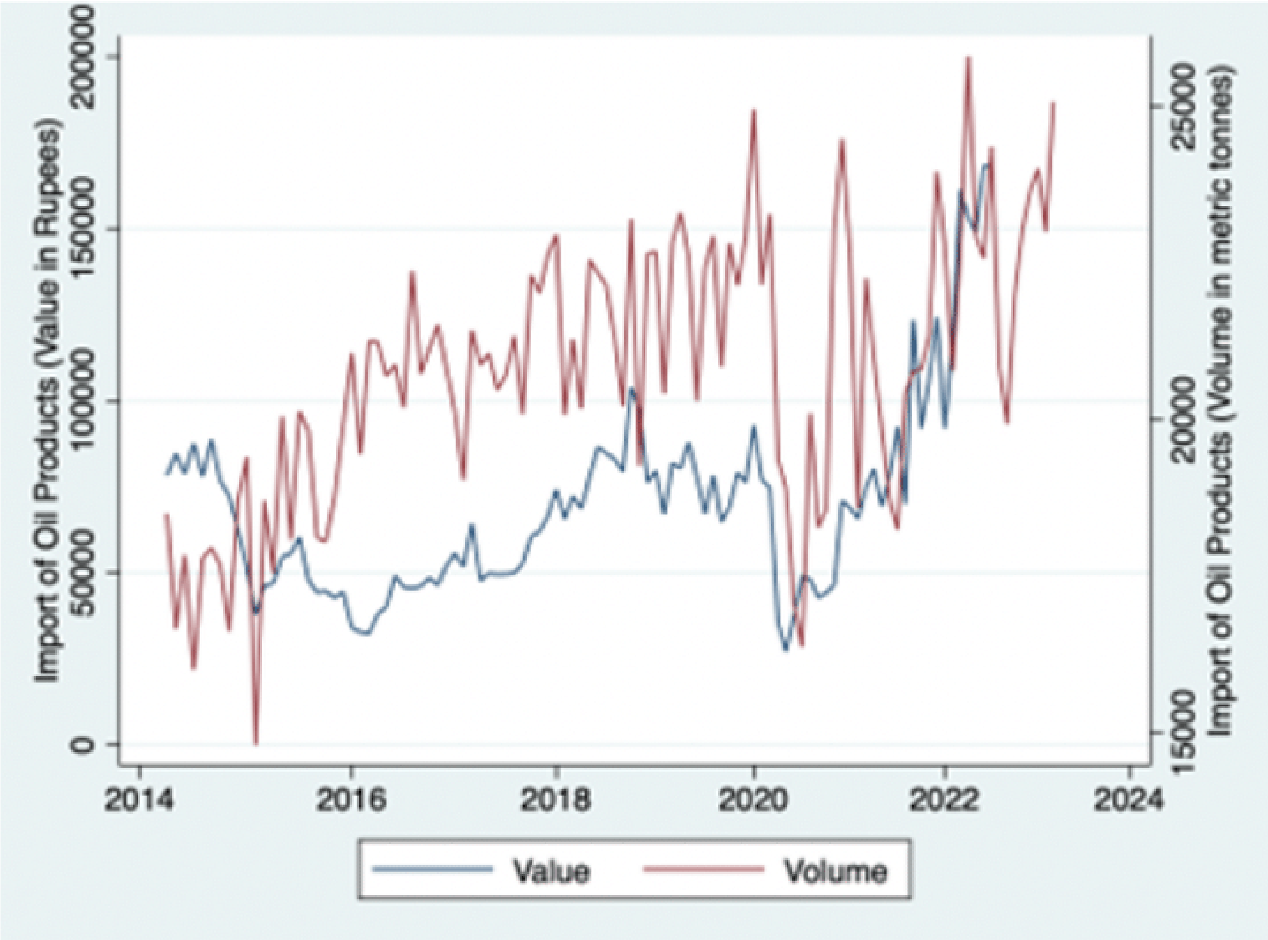
> It is in this scenario that one must investigate India's own energy requirements and the pricing choices that have been pursued in the current regime.

India's Tryst With 'Seller's Inflation'

Since the BJP government has come into power, India has seen its import demand of oil growing steadily, with import of crude oil and other petroleum products nearly tripling in volume between 2014 and 2022.

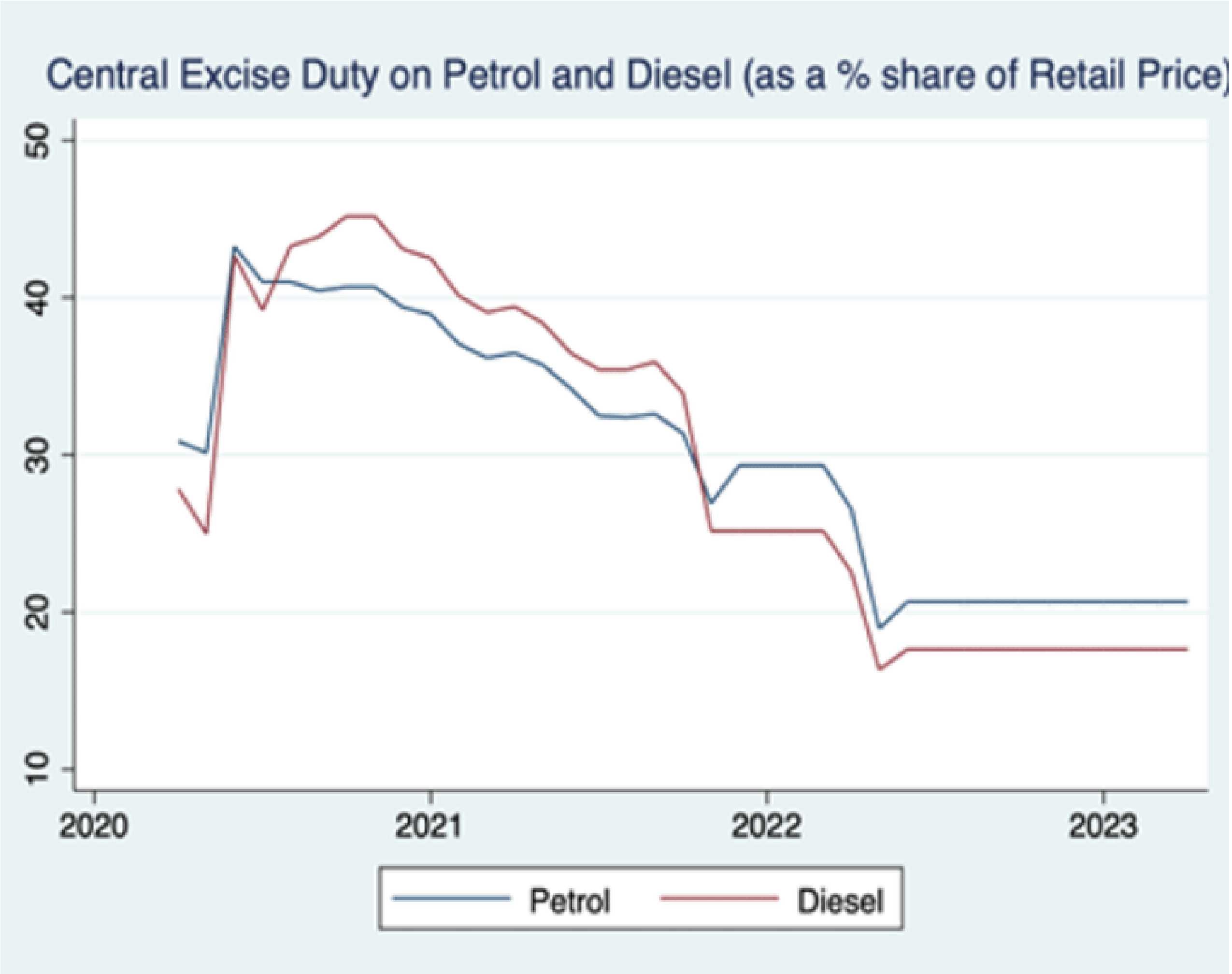
This growing demand for energy has also been observed in the composition of merchandise imports between the same range, with imports of oil products nearly doubling in its value from Rs 78,281 crores in April 2014 to Rs 1,68,226 crores in July 2022 (see below).

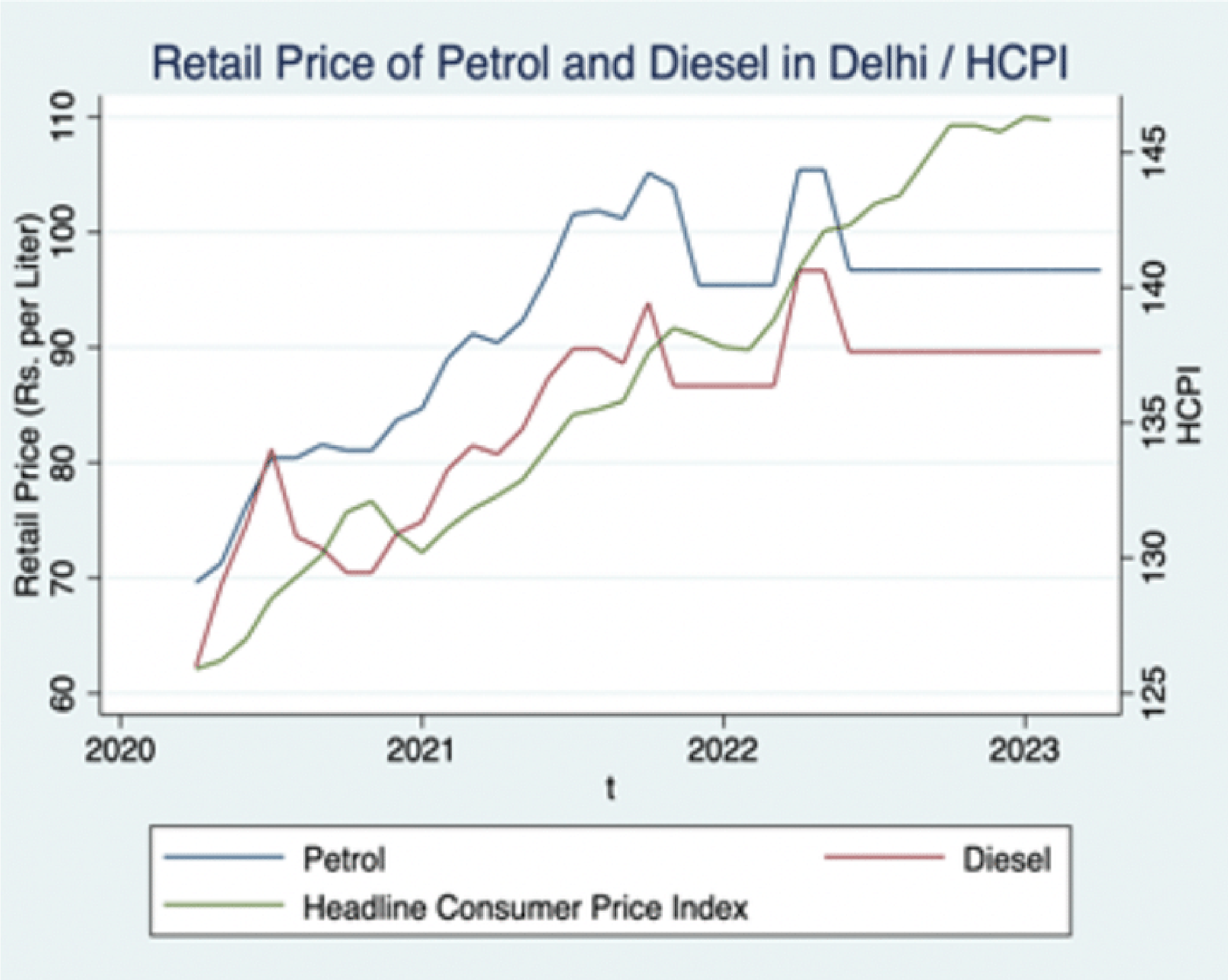




While this rising import bill may present an issue for any government, through imposing taxes, the government has been able to contain the prices of oil products such as petrol and diesel in a narrow band.

Taxes on oil and petroleum products form a major part of the retail prices borne by the consumers.


Central Excise Duty on Petrol and Diesel (as a % share of Retail Price)
50
40
30
20
10
2020
2021
2022
2023
Petrol
Diesel



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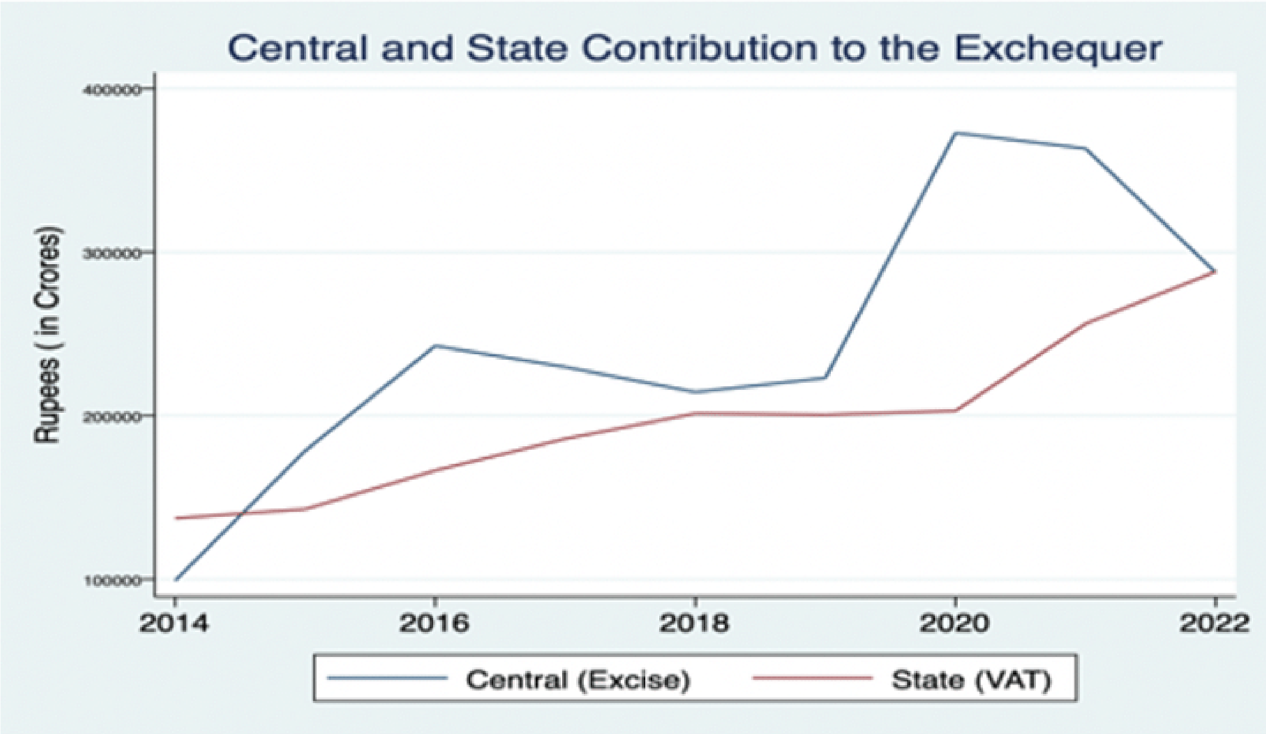
To take the example of Delhi, of the current retail price of petrol, which is Rs 96.72 and of diesel, which is Rs 89.62, excise and VAT takes up 36 percent and 31 percent of the prices respectively.

At the precipice of rising energy prices in late October 2021, this share used to be 54 percent and 49 percent respectively.

Of this, Central excise duties held a larger share than that of the State government's VAT, which was calculated on a percentage basis.

> The central government keeps a fixed rate of excise duties on the base price of petrol and diesel, which has contributed to an increasing dependence on the revenues from such duties.

Of the total tax contribution from the petroleum sector to the Exchequer, excise duties levied from petrol and diesel has accounted for nearly 75-90 percent in the last 10 years (for state governments, VAT from petrol and diesel has accounted for 85-95 percent during the same period).



The Fog of Disinformation Surrounding Oil Prices

Historically, prices of both diesel and petrol were determined by the Administered Price Mechanism till 2002, under which objectives like stability and protection of consumers were pursued.

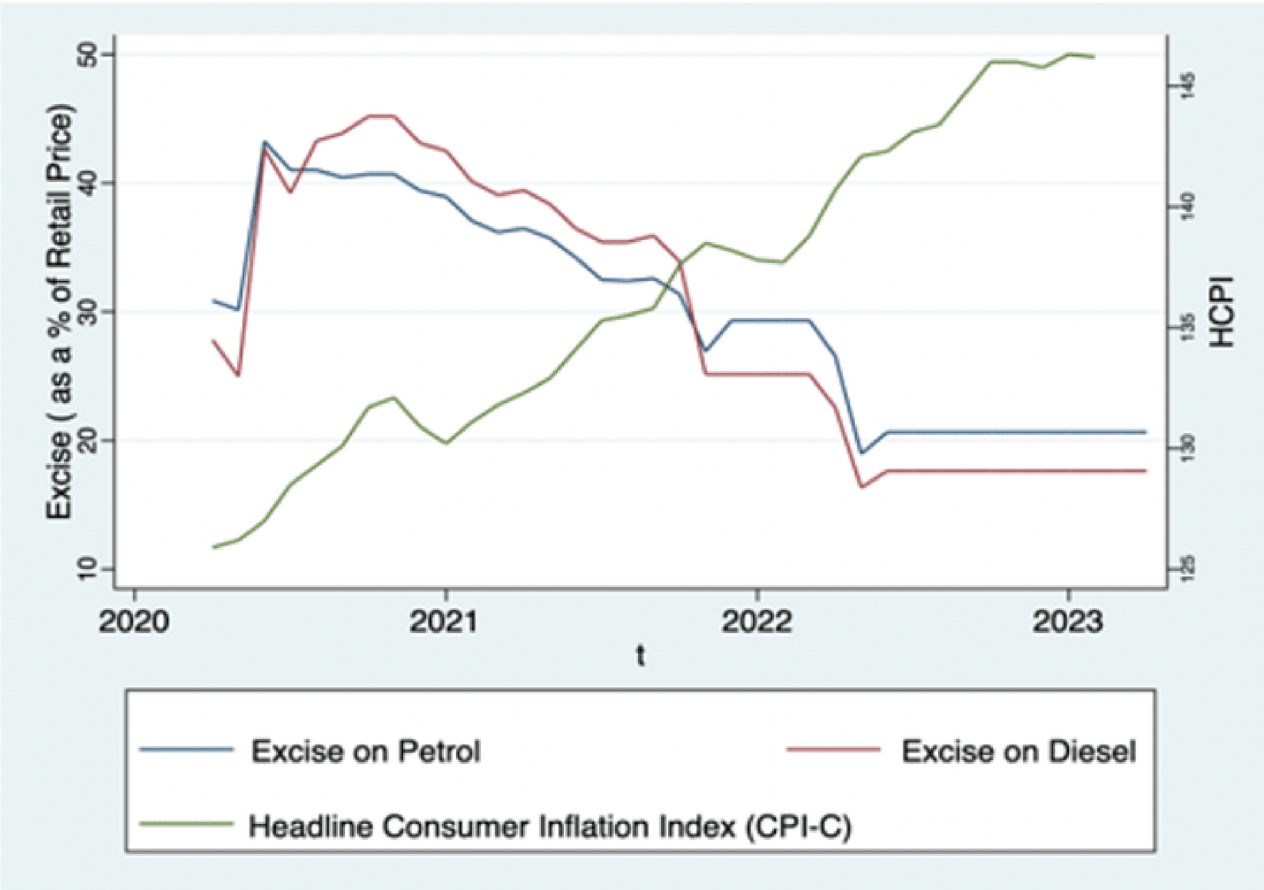
Even though this mechanism was discontinued, efforts were directed by the government-run oil manufacturing companies (OMCs) like IOCL, HPCL and BPCL to maintain the interests of the consumers at a priority.

After a brief stint of market determined prices, the OMCs have taken up the mantle since 2014 to revise the fuel rates daily, by considering the crude oil prices in the international markets, and the rupee-dollar exchange rates.

> As prices surged during the height of COVID years, profits experienced by these companies also experienced a spike, only coming to a halt when price freeze was implemented despite rising costs in early 2022.

As prices of petrol and diesel have hovered around Rs 100, despite the cut in excise duties, it remains to be seen how the oncoming production cut will be managed by the government.

Leading up to the general elections of 2024, OPEC’s decision to cut production would certainly not bode well for the government’s fuel import bill. Also, with the dollar exchange rate already at record high despite RBI intervention, and inflation already high, the incoming rise in fuel costs is surely expected to add to the fire.

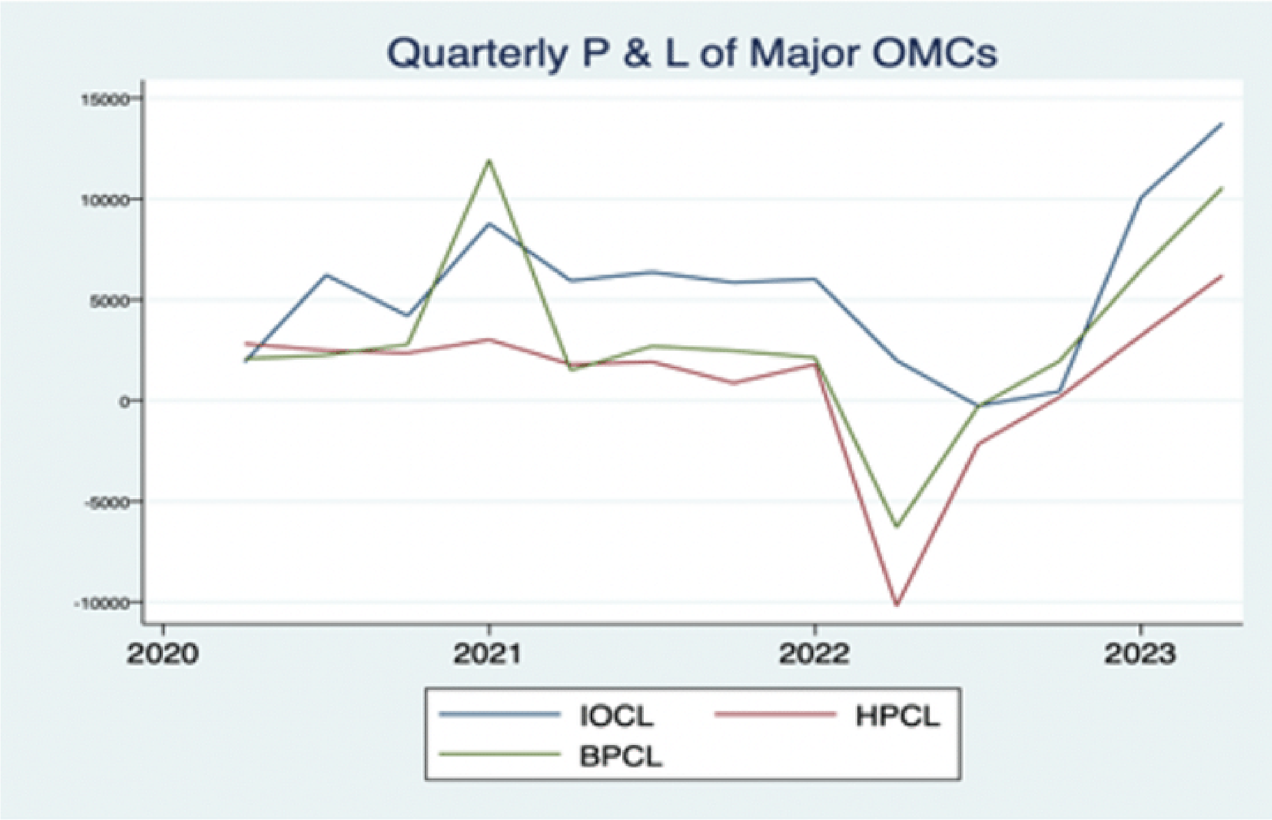


The spinoff in the narrative projected by the Modi Government in managing the headlines around fuel inflation is also interesting.

It first allows the price of retail petrol and diesel, much like LPG, to scale up, citing ‘external factors and geopolitical concerns’ while allowing the government to beef up revenue and oil companies to make abnormal profits, and then lowers them marginally - closer to the election cycle-citing gratitude of the prime minister.

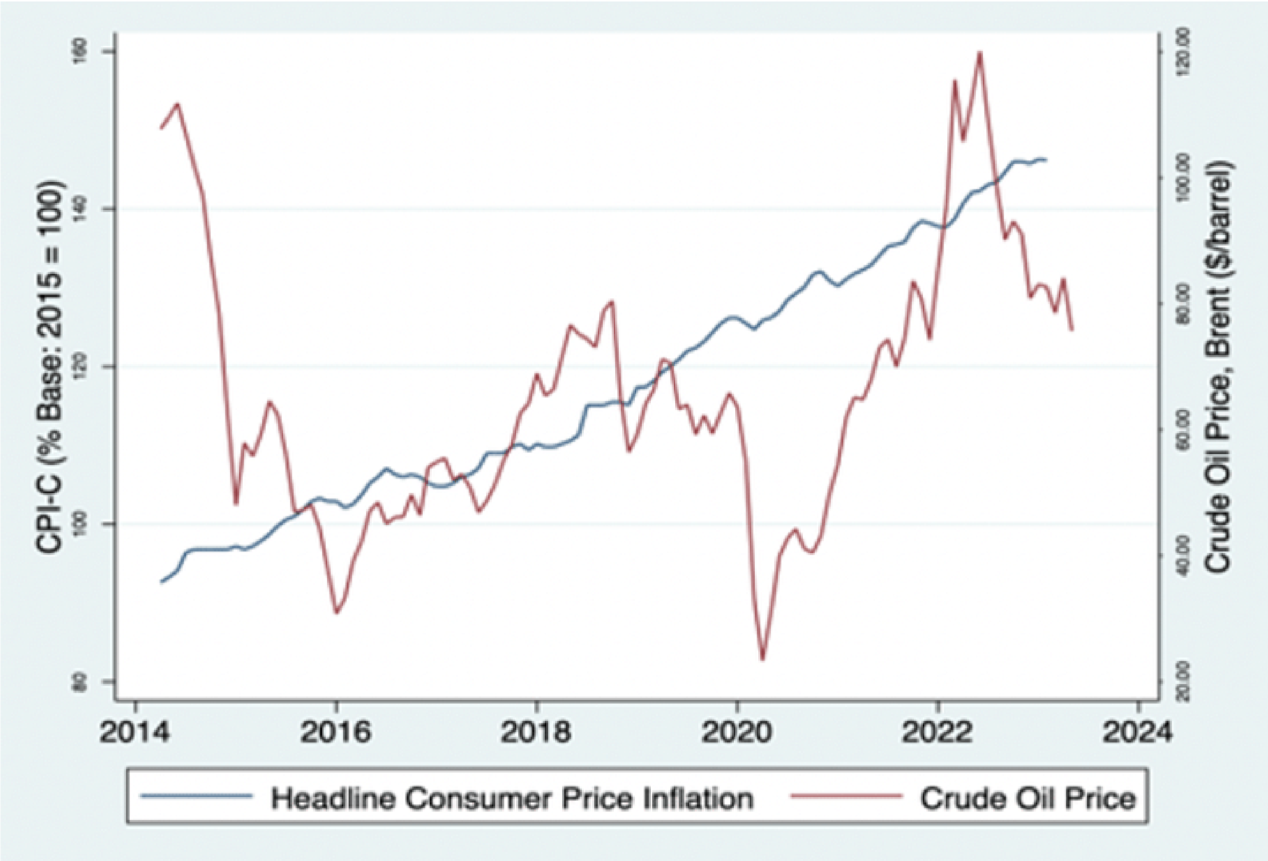
What is critical is observing and seeing through the fog of this disinformation, cloaking the truth behind what’s happening to fuel and subsequently to *seller’s inflation* in India.

See below the profit/loss levels of major OMCs.



From hitting rock bottom post 2022, companies have recorded profits consistently from thereon.

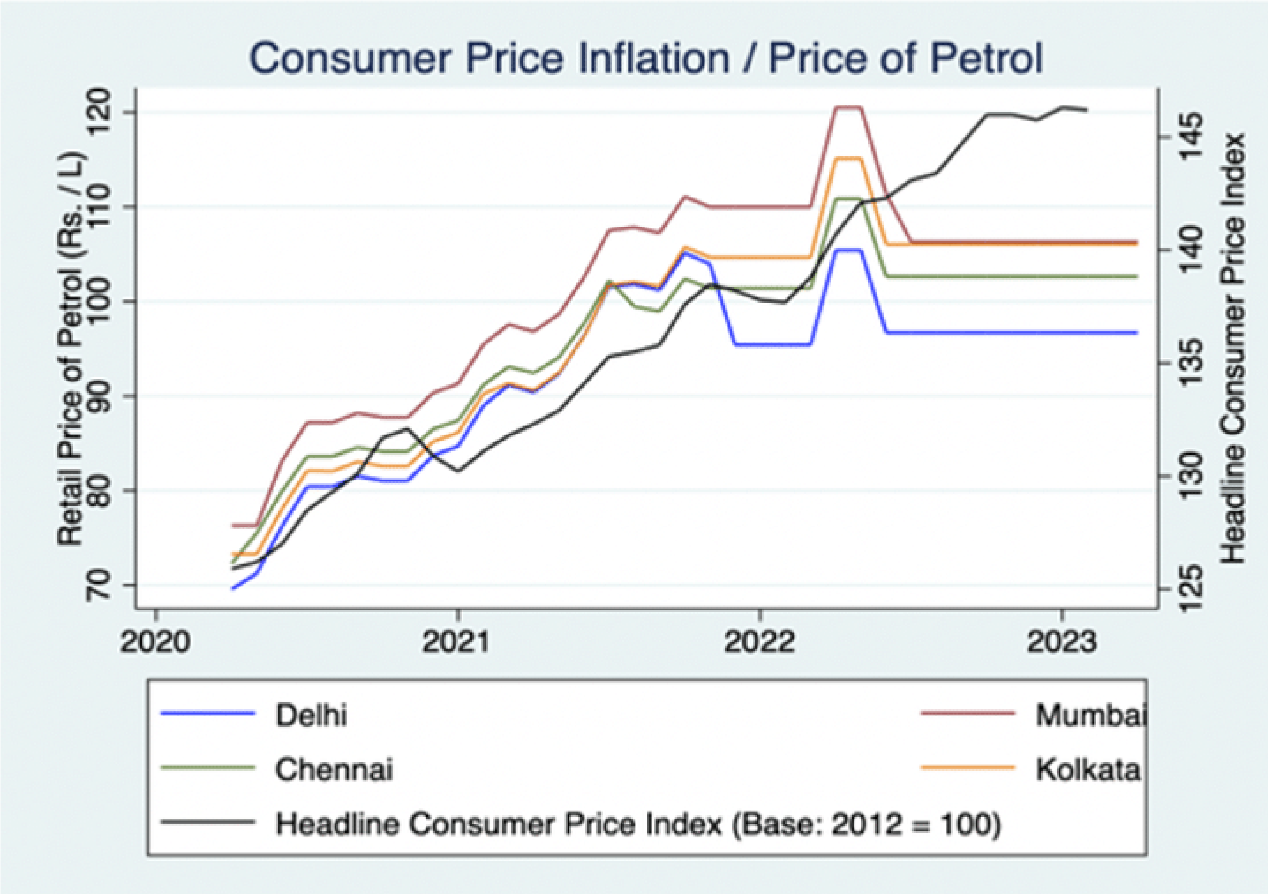
If we see the nature of relationship between headline inflation and crude oil price, in the figure below, one will see how between the period of 2018 and early 2023, inflation remained high despite a gap in oil prices.



Key Questions That Need to be Answered

Yes, in many countries, supply-side disruptions were majorly contributed to the initial rise in price, but if one looks closely in context to India alone, sustained high fuel prices because of high tax/cess and the government's failure to pass on the benefit of lower import cost (when crude oil price was low), had a cascading effect on firm-level transport costs, leading to a higher cost-push inflation in CPI-from which most companies (not just OMCs) profited at the expense of the poor.

The chart below provides a mapping between CPI-Oil price numbers across major cities that are engines of urban growth across India.



Therefore, there are key questions that remain to be answered on part of the Modi government as it enters the 2024 election cycle with key issues of low growth, high inflation, and low employment.

How did the Central government profit by the windfall gain realized in crude oil price import bill when global oil prices came down and the Indian government imported cheaper Russian crude oil (while justifying doing so for consumer-cost benefit reasons)?

To what extent did the government allow oil, gas, petroleum, and petrochemical companies to profit as they gained from the cheaper crude oil price import cost without passing on the benefit in terms of price reduction to consumers?

Is there a windfall profit tax (like Europe) left to be imposed on these companies?

A lot remains left to be answered.

(Deepanshu Mohan is Professor of Economics and Director, Centre for New Economics Studies (CNES), Jindal School of Liberal Arts and Humanities, O P Jindal Global University. Yashovardhan Chaturvedi works at CNES. This is an opinion piece and the views expressed are the authors' own. ***The Quint*** *neither endorses nor is responsible for them.)*

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