The Modi Government Must Answer for its Exploitative Fuel Price Policy

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This analysis has been undertaken by members of the InfoSphere team of Centre for New Economics Studies (CNES), Jindal School of Liberal Arts and Humanities, O.P. Jindal Global University. To review their previous work, please visit the website here or write to the team at cnes@jgu.edu.in

India's high inflation problem over the last couple of years – anchored by a consistent fuel price hike – is embedded in an act of price collusion observed by the Indian government and the oil companies, who were importing cheaper crude oil (when it was made available). These companies profit from this practice, making the Indian consumers pay for a high retail price for fuel along with the windfall gain made in profits.

The problem has been highlighted in the evidence produced by economists like Isabella Weber in Europe – and India's case isn't too different.

The unfortunate reality of price collusion when the underlying market conditions remain oligopolistic (where few dominant market players determine the selling price of a commodity) allowed firms in manufacturing and services to work in tandem with the government that seems comfortable in letting firms to profit from the price divergence (in volatile priced commodities like oil) without passing any dividends to the consumers.

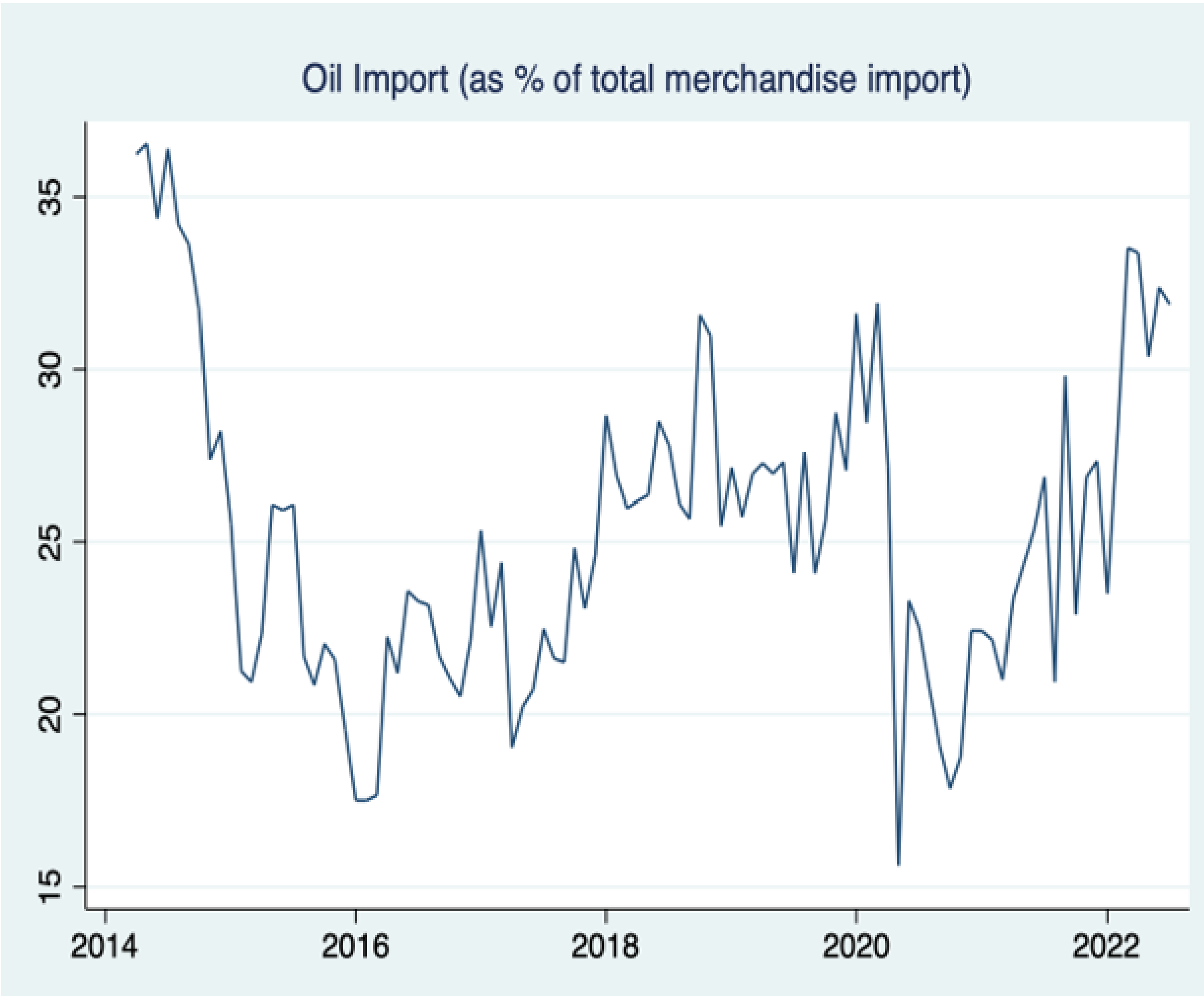
The government, in fact, kept tax on fuel hiked at a time when the imported price of crude oil was collapsing all over the world. Even during the Russia-Ukraine war, the benefits of imported cheaper Russian crude oil wasn't passed over to the retail sale price of fuel. This made the overall inflation rate to continuously remain high, even when food inflation was moderate (which now is peaking because of ineffective monsoon and other supply-side concerns).

What determines India's fuel prices? Are the global market geopolitical considerations really to blame for the high costs consumers have to bear? Not really, is the answer – and below we'll break down why. Here are the key takeaways from the energy woes in India – and the government's handling of it.

Growing demand

India has seen its import demand of oil growing steadily over the last several years, 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 period, with imports of oil products nearly doubling in value from Rs 78,281 crore in April 2014 to Rs 1,68,226 crore in July 2022.



Source: CNES-InfoSphere

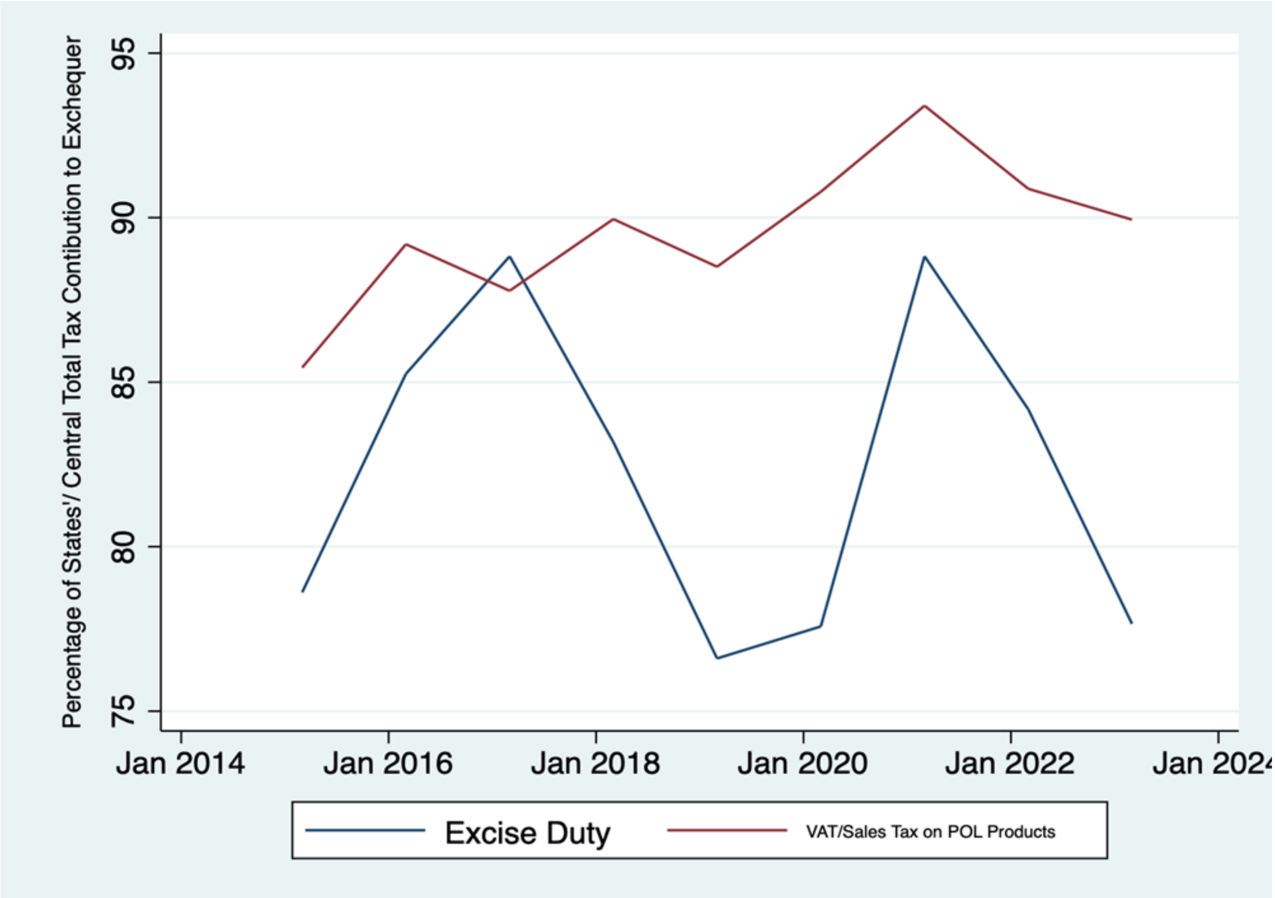
Government revenues – more for the Union government than the states

In the last year, global oil prices have been falling. But in India, the government has contained the prices of oil products such as petrol and diesel in a narrow band using its taxation policy.

The tax component in the prices of motor spirits has been a major source of revenue for the Union government. Taxes on oil and petroleum products form a major part of the retail prices borne by the consumers.

To take the example of Delhi. Of the current retail price of petrol (Rs 96.72) and diesel (Rs 89.62), excise and VAT take up 36% and 31% of the prices, respectively. At the height of rising energy prices in late October 2021, this share used to be 54% and 49%, 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.



Central excise duties held a larger share than that of the state government's VAT, which was calculated on a percentage basis, from January 2014 to January 2023. Source: CNES-InfoSphere

The Union 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% in the last 10 years (for state governments, VAT from petrol and diesel has accounted for 85-95% during the same period).

How the price is decided

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

Even though this mechanism was discontinued, efforts were directed by the government-run Oil Marketing 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 rate. As prices surged during the height of the COVID-19 years, profits experienced by these companies also experienced a spike, only coming to a halt when a 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 will 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 exacerbate the situation.

The government's playbook

The narrative projected by the Narendra Modi government in managing the headline fuel inflation is also interesting.

It first allows the price of retail petrol and diesel, much like LPG, to rise, citing 'external factors and geopolitical concerns'. This allows the government to boost revenues, and oil companies to make abnormal profits.

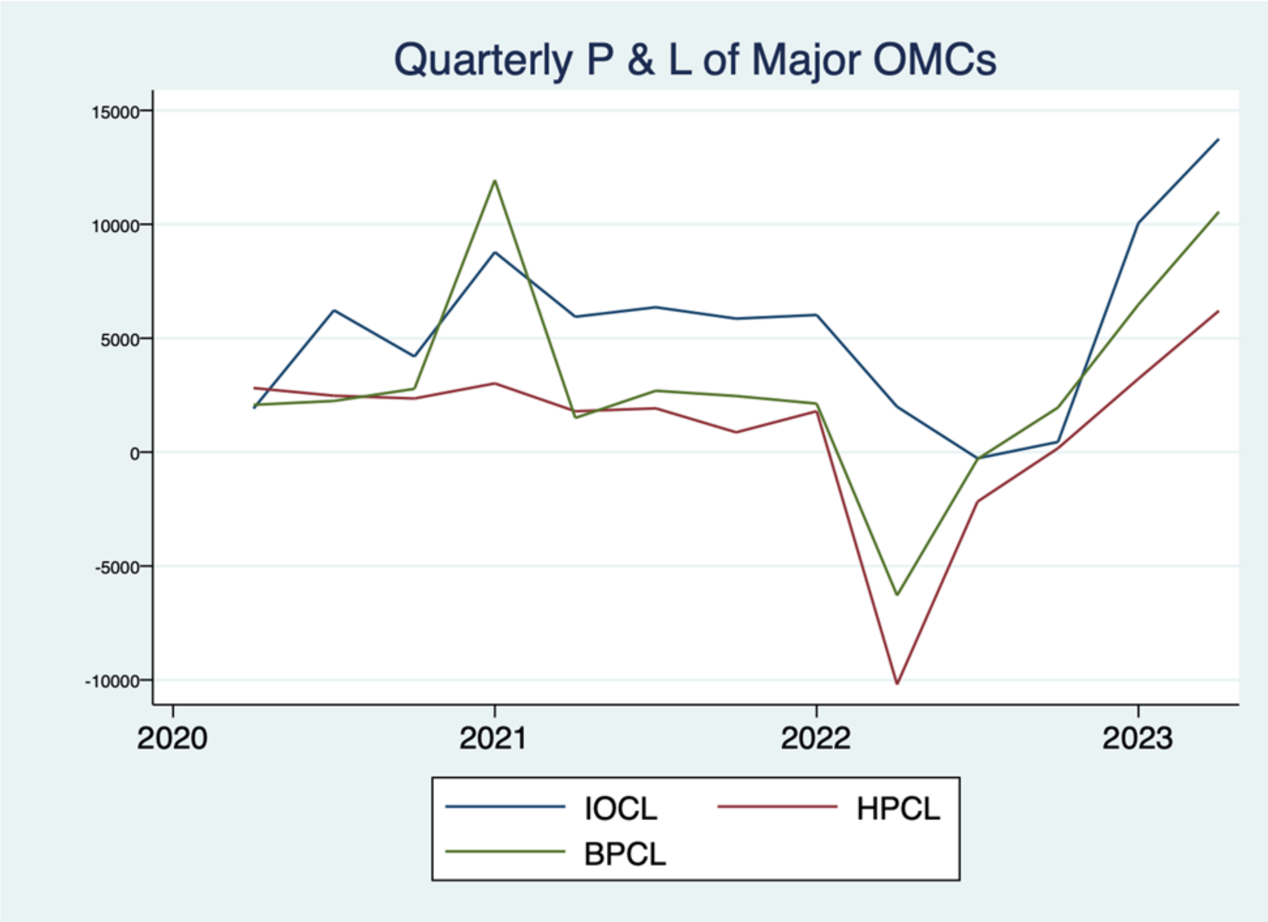
Also read: LPG Price Cut: Modi's Rakhi 'Gift' Ends up Drawing Attention to Inflation

Then, the government either does not increase the prices or keeps the prices lower, marginally, usually when it's nearing an election cycle. They attribute these efforts to the prime minister, who is allegedly working to bring down the prices.

Cutting through the fog of this disinformation, unmasking the truth behind what's happening to fuel is important.

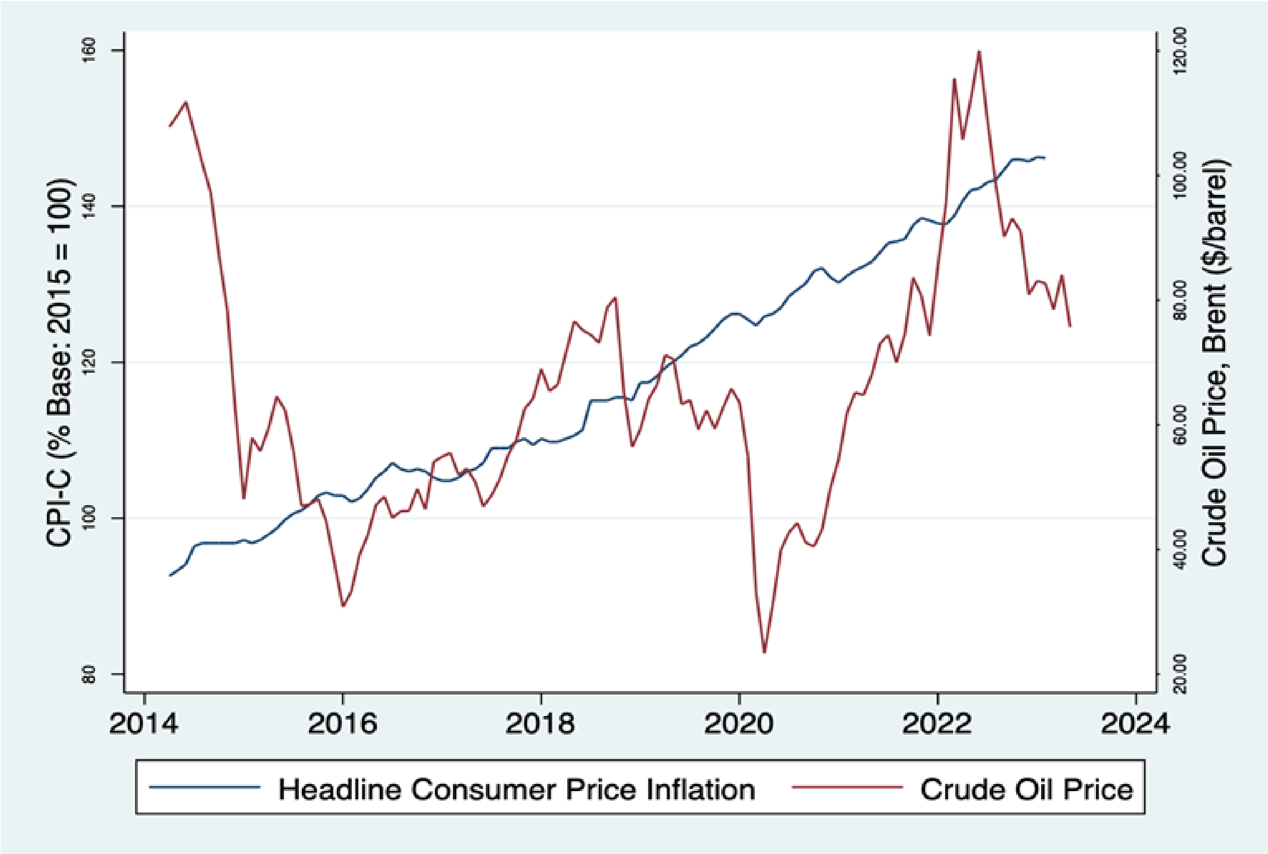
The truth is that high excise in the period of high domestic prices, despite record low prices on international crude, means the Union government has already made a high windfall gain in excise tax revenue which should enable the consumers to not 'pay for' high international prices.

See below the profit and loss levels of major OMCs.



Source: CNES-InfoSphere

After hitting rock bottom post-2022, companies have recorded profits consistently from thereon. If we look at the relationship between headline inflation and crude oil price, in the figure below, one will see how between 2018 and early 2023, inflation remained high despite a gap in oil prices.



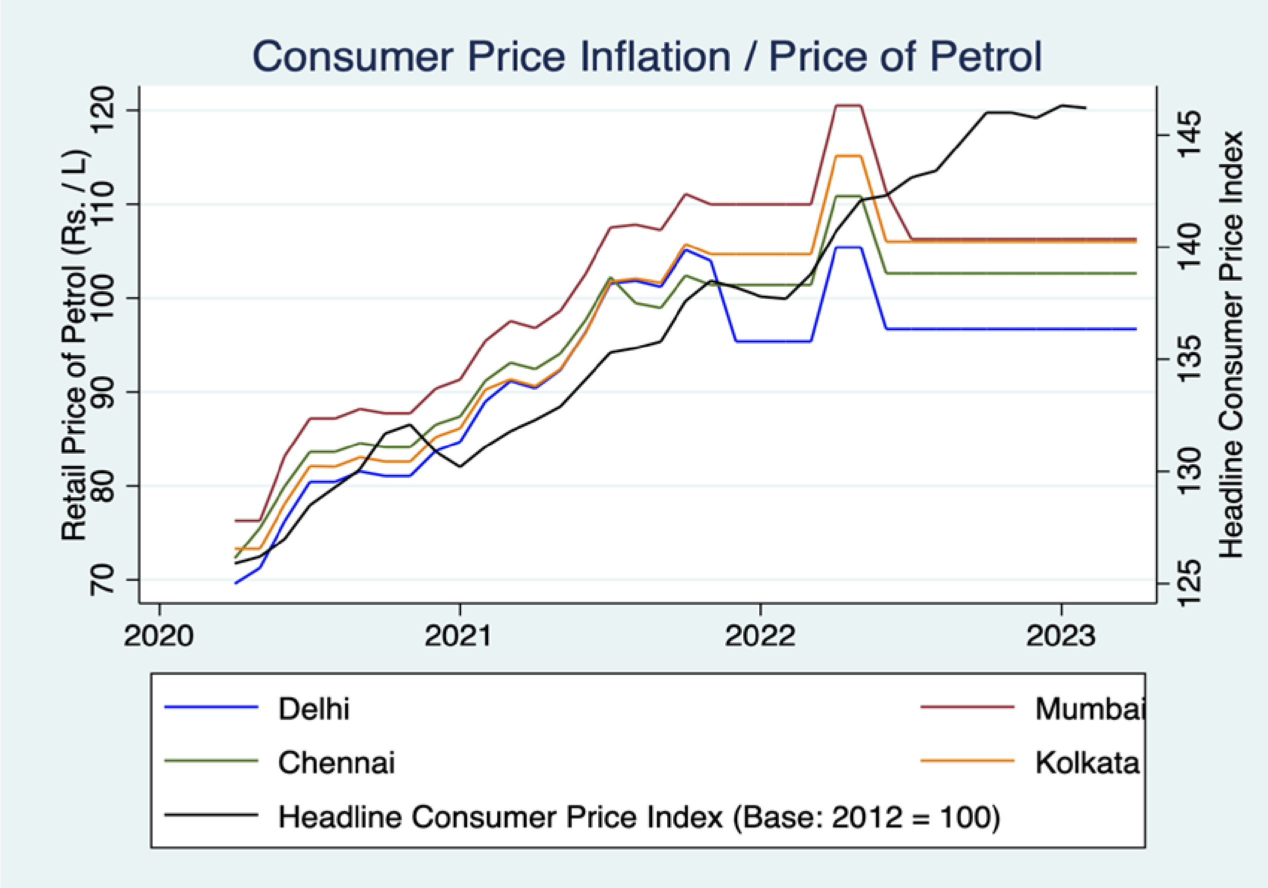
Source: CNES-InfoSphere

Also read: Households in Delhi Spending 25% More on Fuels, Electricity Than in 2021: Report

Consumers pay, companies benefit

In many countries, supply-side disruptions majorly contributed to the initial rise in price, but if one looks closely at India alone, sustained high fuel prices – because of high tax/cess and the government's failure to pass on the benefits 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 and oil price numbers across major cities across India.



Source: CNES-InfoSphere

Questions awaiting answers

The key questions that remain to be answered on part of the Modi government in India as it enters the 2024 election cycle with key issues of low growth, high inflation and low employment are: How did the Union government profit by the windfall gain realised in the 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 has the government allowed 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?

Voters deserve to know these answers.

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