

Petrol Price Hike – The Myth of Subsidy!

The Petrol Price has been hiked by over 10% overnight, and as usual, specious arguments about “loss making Oil PSUs”, “sharp depreciation in Rupee” and “Government cannot subsidize the Rich for their petrol cars” are spouted to justify this humungous hike! A quick 101 on the building blocks of the street price of petrol would debunk each of these specious arguments to smithereens!

The Cost Breakup

The Indian basket of Crude Oil is at about USD 100 today (NYMEX is at USD 90.32, Brent is at USD 107.4 Source: <http://www.bloomberg.com/energy/> and Indian basket is usually at 5-7% discount to Brent). At today's exchange of Rs. 56 per USD (the worst ever!), this works out to Rs. 5600 per barrel, which is still 6% cheaper than the highest price of Rs. 5900 recorded in August 2008.

Lets us look closely at how this translates to cost per litre of petrol!

A barrel of Crude produces approx. 150 litres of Petrol or its equivalent. (This is a broad generalisation and depends on type of crude, efficiency of the refinery etc. but is a reasonably good estimate, based on expert inputs).

The total of all other costs involved in converting crude to Petrol – which includes transport of crude and refined products, cost of refining, reasonable refining margin for the refinery, fuel used by the refinery, dealer commission, etc. – is approx. USD 12, which works out to Rs. 672 per barrel.

Now, this totals up to a final cost of petrol, at your nearest petrol bunk, at Rs. 42 per litre! YES, it is a little less than Rs 42 per litre, shorn of all taxes! $[(5600+672)/150]$. This morphs to Rs. 77 – 81 per litre, adding taxes at different levels under various heads – Basic Excise duty, Additional Duty, Special Additional duty, Cess, Additional Cess and lastly, the exorbitant State Sales Tax – adding up to Rs. 35-40 per litre of Petrol. These are the taxes and duties that the Governments – both centre and state – happily splurge on populist policies with an aim of making every citizen a beggar of Govt. doles!

Myth 1 – “Oil PSUs’ losses have to be arrested”

Now, dear readers, do you agree that the “Oil PSUs are loss making?” in the real sense? If they stop paying their sales tax and excise duty, won't they be rolling in cash? The real issue is the warped duty and pricing structure! The unintended adverse side-effects of this warped duty and pricing structure are

a) Oil PSUs now shy of investing money for creating new refining capacity

- b) Much needed resources for exploring fresh oil sources are deprived
- c) Investors run for safety (Niko Resources pulled out of India citing this yesterday!)
- d) Corporate Governance takes a severe beating – all these Oil PSUs are listed companies, and minority shareholders like you and me are taken for a royal ride!

All these are crippling India's natural geographical advantage of being closer to Middle East, and distant countries like Singapore and Indonesia are happily creating fresh refining capacities!

Myth 2 – “Sharp Depreciation of Rupee”

The depreciation of Rupee, by about 10% in the recent months from Rs. 51 per USD to Rs. 56 per USD has been MORE THAN OFFSET by the almost 20% decline in the global crude oil prices from USD 120 per barrel to USD 100 per barrel. Moreover, the sharp depreciation in the exchange rate is, in all probabilities, an over-reaction of the market to the global turmoil and it can be reasonably expected that RBI would intervene to soothe the nerves of the market which will have a sobering effect on the Rupee. So, the rupee depreciation is NOT a justifiable reason for hiking petrol price today!

Myth 3 – “Government cannot continue to subsidize the rich”!

This is the unkindest cut of all! As we saw just now, at the cost price of Rs. 42 per litre and a selling price of Rs. 70 per litre (before this overnight hike!), who is subsidizing whom? After today's hike, the total taxes work out to whopping 83% on the basic price! How much more will this Govt add on the common man's back? Till it breaks, I guess!

At this price, even diesel is NOT a subsidized product as the cost is exactly the same at Rs. 42 per litre for Diesel (the refining process yields all final products at almost same cost!), which is sold at Rs. 44-46 per litre! So, they should spare us these sermons on “Govt subsidizing the rich for their cars and two wheelers!”

In March 2012, the Chief Minister of Goa, Mr. Manohar Parrikar, has shown us all the way forward, by announcing a reduction of Rs. 11 per litre of petrol! I sincerely hope many other states follow this brilliant yet popular move and expose these popular myths going around about petroleum pricing!

Courtesy: Muthuraman in Centre Right India