IIM study suggests deregulation of oil sector

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An Indian Institute of Management (IIM), Ahmedabad, study on the oil sector has suggested radical reforms, including complete deregulation, where private and public sector firms are free to price fuel as they deem fit.

"Reform of the oil sector is long overdue. The problems in the sector emanate from the structure of central taxes and the system of subsidisation through prices," the study said.

Currently, the government controls prices of petrol, diesel, domestic LPG and kerosene and compensates public sector firms through a complex mechanism that has squeezed out liquidity with the retailers and drained resources of upstream firms.

It gives oil bonds to make up for a part of the revenue lost on selling fuel below cost and asks upstream operators like ONGC to bear the rest. "The social and fiscal costs arising out of the current method of subsidisation, and taxation are very severe," it said.

Suggesting radical reforms, the study said, "Complete deregulation of the sector allowing oil producers, oil refiners, marketing companies, and integrated operators to price their products as they deem fit" is needed.

PARADIGM SHIFT

- The study fovours radical reforms for the sector, including complete deregulation, where private and public companies are free to price fuei as they deem fit
- At present, the government controls prices of petrol, diesel, domestic LPG and kerosene and compensates public sector companies through a complex mechanism
- Fiscal costs are very large and much larger than that reported in the Budget since they do not include the costs of diversion and tax avoidance that result from differential pricing
- The social losses (of present system) include misuse/wasteful use of scarce petroleum resources, diversion, adulteration, other avoidable negative externalities, improper substitution between products, tax arbitrage, distortion of consumer preferences and input choices of industries, and international cross-hauling of petroleum

It said the fiscal costs were very large and much larger than that reported in the budget since they do not include the costs of diversion and tax avoidance that result from differential pricing. "Thus in the case of kerosene the cost of delivering Rs 2,000 crore to the BPL consumers was in excess of Rs 24,000 crore."

The social losses (of present system) include, misuse/ wasteful use of scarce petroleum resources, diversion, adulteration, other avoidable negative externalities, improper substitution between products, tax arbitrage, distortion of consumer preferences and input choices of industries, and international cross hauling of petroleum.

"There is sufficient degree of competition in refining, marketing and retailing to ensure that (fuel) prices across locations do not vary by more than the difference in logistic costs of delivery to the locations from the cheapest sources," the study said.

The public distribution system, it said, was "not necessary and ought to be dismantled." Subsidies should be administered through endowments defined upfront, the study suggested.

"The political difficulties in carrying out tariff reform have been exaggerated. Earlier, expert committees have ignored the use of direct endowment subsidies, which potentially could remove the distortions by liberating subsidies from prices. Such an approach by preserving and enhancing consumer benefits to the subsidised sector can only be politically rewarding."

Excise duty needs to be recast into a value added tax, as for any other product, so as to allow input credit for all registered intermediate users of petroleum products, including the oil companies themselves, leaving out only truckers, taxi operators and other small intermediate users.

"Central government revenues can be protected by working out a revenue neutral value added tax rate. This we have estimated approximately to be 110-120 per cent of value added uniformly to all segments in the industry". "Such a tax regime would also be neutral to the degree of vertical integration and remove the biases in the use of products," it said.

Alternately, it suggested creation of a 'Crude Price Stabilisation Fund' that allows crude prices (both sharp rises and sudden falls) to be moderated, so that pass thru is influenced by the managers of the CSF.

Recommending a corpus of $40 billion, the report said CSF can be used to moderate prices in case of a steep rise in international oil prices.

The study called for complete freeing of imports and exports and removal of all residual restrictions. "Only pipelines (should be) subject to regulation by the Petroleum and Natural Gas Regulator," it said.

The IIM study said: "Above all we would emphasise that on political expediency or the social dimension our proposals cannot be rejected since on both these counts they are actually value enhancing. They would create much political good will for the government initiating reform, benefit the poor and the consumer. It would also result in vast fiscal savings."

As a third alternative, it suggested a "better APM (Administered Pricing Mechanism)" which involves regulating refineries by awarding them an internationally referenced standard refining margin.