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Kunal Kumar Kundu: The LPG roadblock

With the recent easing of crude prices, the policy of monthly incremental changes in the retail price of diesel is on the verge of paying off. As of now, the under-recovery for every litre of diesel sold has come down to a mere eight paise per litre. This means that by next month, the next diesel price change may well be a cut, unless the global price of crude starts to rise again or the rupee depreciates from the current level.

While diesel prices will cease to be a headache for the government, this does that mean that India's oil subsidyproblem is over. For starters, the government has not spelt out its future strategy with regard to diesel prices. It has not been announced that diesel prices will be market-determined going forward. Rather, if geopolitical conflicts escalate and crude prices go north, under-recoveries will resurface.

The most immediate concern, however, is the provision of subsidised cooking gas. Given that hikes in cooking gas prices impact a household's budget directly, any attempt to rationalise domestic liquefied petroleum gas (**LPG**) prices is fraught with political connotations, especially given that India's food inflation has averaged nearly 12 per cent per year for the past five years.

As a bulging oil subsidy bill thwarted every attempt to contain the high and rising fiscal deficit, the previous United Progressive Alliance government first attempted to cut the domestic LPG subsidy by restricting the number of cylinders per household to six a year. But they subsequently backtracked and raised the entitlement to nine per year, and by early January, sensing the voters' belligerent mood, had raised it again to 12 per year.

Meanwhile, domestic LPG consumption has been rising. Between FY01 to FY14, consumption increased from seven million tonnes (mt) to 16.3 mt, an annualised increase of 6.72 per cent, which is higher than that of diesel. Despite this, the domestic LPG price has barely moved, boosting the subsidy per cylinder of LPG supplied to households.

This pushes up the under-recoveries. The problem is further compounded by the fact that with indigenous production of LPG remaining at around the same level over the past six years, India is heavily dependent on LPG imports. In fact, as of FY14, close to 41 per cent of the domestic LPG requirement was met though imports.

In India, nearly 90 per cent of total LPG sales are accounted for by domestic LPG (or subsidised) cylinders. As of March 31, 2014, there are 166.3 million consumers. According to market sources, during FY15, India's LPG import could jump to as much as eight mt as a result of increasing the number of cylinders per household to 12. Given that unsubsidised commercial cylinders are sold at prices that are virtually double the price of subsidised domestic LPG, increasing domestic households' entitlement leads to the widespread diversion of cylinders from domestic use to commercial use. According to available data, a decline in bulk LPG sales has been observed since March 2010, which may be mainly due to customers shifting to liquefied natural gas (LNG) and also because of such diversions.

According to the National Sample Survey Organisation household consumption survey for FY12, total rural and urban consumption of domestic LPG was about 12.8 mt, which was 83 per cent of the amount supplied. Clearly, the remaining amount has been diverted elsewhere. According to the same survey, the annual consumption of the poorest 67 per cent of rural households was 5.7 cylinders, while for the poorest 40 per cent of urban households, it was eight cylinders. Clearly, increasing the cap to nine and subsequently to 12 was unwarranted.

The situation will likely deteriorate, given that "Vision 2015" for the LPG sector focuses on raising LPG coverage in rural areas and in areas where its coverage is low. The target is to cover 75 per cent of the rural population by 2015 through upwards of 50 million new LPG connections, equal to virtually one-third of the existing connections. This will mean that the domestic LPG subsidy could potentially rival the diesel subsidy at its peak.

While the phasing out of diesel subsidy and weak oil prices have helped in this regard, unless the government embarks on a clear road map for tackling the potential threat posed by the domestic LPG subsidy, the overall oil subsidy may yet continue to hurt India.

Ideally, the government should start by reducing the annual cap per household from the current 12 cylinders to nine. The next step should be to ensure a fully functional direct benefits transfer mechanism. This way, they can sell the cylinders at market price and transfer the subsidy directly to the bank accounts of only the deserving consumers. This will not only reduce diversion but also ensure that the rich and the undeserving do not enjoy the benefits of a subsidy meant for the poor.

However, with some important state elections round the corner, and given the recent setback suffered by the government in some by-elections, don't bank on a solution any time soon.

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