Dr. Kirit S. Parikh: Biography

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Dr Kirit S. Parikh has a Doctor of Science in Civil Engineering and a Master's Degree in Economics from MIT, USA. He has been a Professor of Economics since 1967. He has also been a Member of the Energy Coordination Committee, Committee on Rural Infrastructure and the Committee on Infrastructure constituted by the Prime Minister. He was the Chairman of the Integrated Energy Policy Committee (Planning Commission). He was a Member of the Economic Advisory Council (EAC) of the Prime Ministers of India, A.B Vajpayee, P.V. Narasimha Rao, Chandra Shekhar, V.P.Singh and Rajiv Gandhi. In the past, he had also been a member of the National Committee for Environmental Planning & Co-ordination, the National Committee on Science and Technology and the Fuel Policy Committee.

He is a Fellow of the National Academy of Sciences, India and Fellow of the World Economic Forum, Davos. In 2003 he was made honorary life member of the International Association of Agricultural Economists. He had been President of The Indian Econometric Society and Gujarat Economic Association. He is on the governing board of many development research institutes in India.

Dr. Parikh had been on the Board of Directors of a number of major industrial firms and financial institutions. Among these are Indian Petrochemicals Limited, Life Insurance Corporation, Industrial Development Bank of India and State Bank of India.

In 1978 he was given the Vikram Sarabhai Award for Systems Analysis and Management. In 1999 he was given the "Vishweshwaraya Award" by the Engineers' Foundation in Kolhapur. He is also a recipient of Nayudamma Award for contribution to the welfare of mankind through developments in the fields of Economics & Energy, February 2005.

In 1997-98, on sabbatical leave from the IGIDR where he was Founder Director from 1986 till 2000, he was Special Economic Adviser to the Administrator, United Nations Development Programme (UNDP), New York. From 1980-86, as Program Leader of the Food and Agricultural Program of the International Institute for Applied Systems Analysis (IIASA), Austria, he directed a research programme involving 300 person years of effort of more than 100 researchers from around the world.

Dr. Parikh has been the editor of "India Development Report" which provides a non-governmental assessment of India's development and policy options. Dr Parikh has authored, co-authored and edited 25 books in the areas of planning, water resource management, appropriate technology for housing, optimum requirement for fertilizers, energy systems and policy, national and international food policies, trade policies, general equilibrium modeling, environmental governance and natural resources accounting.

In February 2010 Dr. Parikh in his report advocated that market forces should govern the prices for petroleum products and insisted on lesser government intervention in the sector. This article aims to understand the recommendations of the committee chaired by Dr. Parikh.

Scenario leading to the formulation of the Kirit Parikh committee

- The Indian consumption of Petroleum products grew at 4% CAGR from 2002-03 to 2008-09. With a high GDP growth and the transition of the economy from agrarian base to industrial base the Indian dependence on oil imports was projected to rise by 90% in 2030, which in turn amidst growth of China and other Asian economies would push the oil prices higher. With this projection in mind, the government decided to pass on the cost of petroleum products, excluding LPG for domestic use, to the end consumer. However this competitive structure formulated in 2002 took a major setback owing to a sharp rise in oil prices in 2004-05
- The cost of crude oil in the international market has fluctuated due to gamut of international events, ranging from US $ 23 / barrel in 2002 to US $ 39 / barrel in 2004-05. This price then almost doubled in the next three years US $72 in 2007, which further doubled to US $ 144 / barrel in July 2008, finally resting at US $ 75 / barrel in December of 2009
- In order to shield the economy and the consumers the Govt. decided to fix prices for sensitive petroleum products, like Petrol, Diesel, Kerosene and LPG. As the prices were below cost the Govt. devised a compensation mechanism for Public Sector Oil Marketing Companies (OMC), viz. ONGC, GAIL, OIL, by means of discounts and issue of bonds
- Hence during the given period from 2002-03 to 2008-09 the OMC`s suffered from under recoveries of Rs 2,99,222 crore, which were only partly compensated by issue of oil bonds to the tune of Rs 1,42,203 crore and upstream PSU contributing 1,01,285 crore. It is important to understand that under recovery is not the same as losses. Cost per barrel of oil does not include the cost of refining crude oil to desirable products, this refining is out sourced and the cost of this has to be borne by oil companies and eventually by the consumer. The difference in this cost and the cost price is the cost of under recovery. The table below from Dr. Parikh`s committee report summarizes the extent of under recovery for OMC`s for the given period
- As a result of these under recoveries there were a number of unsustainable outcomes:
    1. Due to the relative low cost, demand for diesel and petrol based products zoomed even in a phase of economic slowdown.
    2. As private OMC`s were not a part of the subsidy sharing arrangement they closed down their retail marketing business across the country, resulting in a major setback to the competitive sector of the petroleum product market.
    3. Time taken by the Govt. in processing the bonds, led to severe cash flow constraints for these OMCs, forcing them to borrow capital from the market and consequentially affected their overall profitability, which declined by 60% in the given time period. Lower profitability reduces investments in R&D hence discouraging innovation. The details of the lowered profitability of Govt. owned OMC`s have been represented in the table below.
    4. During this period the Govt. was subjected to a cumulative burden of 1,42,000crore at 25% cost of capital annually, thereby restricting the flow of capital to other development projects across the country. The committee report aims to provide a viable long term strategy for pricing major petroleum products.
- Intervention through price controls implies that someone bears the financial cost. The objective of the committee was to analyze who bore the brunt of these costs, i.e. was the cost difference met by an increase in tax, or increasing fiscal deficit or by cutting other government expenditure. Each of these measures affects certain factions of the society adversely

- Additionally price control, taxes and subsidies introduce undesirable distortion resulting in inefficient use and erroneous choice of technique. For example cheaper diesel meant diesel replaced furnace oil. High price gradient between diesel and petrol promoted the use of fuel inefficient SUV`s running on diesel. Kirit Parikh committee recommended carefully thought of intervention of the government restricting it to the supply of LPG to the poorest faction of the society

Policies, Objectives and Recommendations

The Kirit Parikh committee report aims to answer the fundamental question: Should the government intervene at all in the market and set prices? In fact despite earlier recommendations why did the government intervene?

The Government intervention was to safeguard the poorest consumer who used kerosene for lighting. Another reason may have been, that in the absence of natural gas for fire there will be a marked increase in firewood and hence encourage deforestation. Further usage of dung as fuel instead of a fertilizer is marked with increase respiratory diseases, eye infections and premature death of women and children. Another reported reason for Govt. intervention is to insulate domestic economy from the volatility ofpetroleum prices. It feared that the complete pass through of the world petroleum prices would increase inflation raising the cost of living.

Further Indian politicians believe it is politically impossible to decontrol oil prices. They fear that freeing oil prices will stoke inflation, because of the impact on transport costs. But in countries with free oil pricing, like the US, inflation excluding food and energy has been less than 1% although oil prices have doubled in the last 12 months. It is simply untrue that price decontrol leads to inflation. On the contrary it leads to efficiency, conservation and a switch to alternatives. It will also reduce the fiscal deficit, and that will tame interest rates and hence prices.

It is important to understand that in the 60`s oil was decontrolled but steel was controlled on the ground that it was politically impossible to free a commodity so vital to the economy. But steel was decontrolled in the 1980s and proved no problem at all.Voters understand that commercial producers need to sell at market prices, but know that governments can subsidize goods indefinitely. As long as oil bears a political price, voters will resist any price increase. But if oil is decontrolled, voters will soon accept the realities of the market, as it already has for steel.

In line with all this, the Kirit Parikh committee aimed to provide a viable long term strategy for pricing major petroleum products. The objective of their recommendations, which are mentioned below, is to limit the fiscal burden on the government and keep the domestic oil industry financially healthy and competitive. With 80% of oil demands met by imports, it is of paramount importance that the government promotes alternate ways to meet energy requirements. By analyzing the purchase trend of petroleum products, the Kirit Parikh committee gave the following set of recommendations:

- Identifying that petrol is largely a product of final consumption Kirit Parikh committee report recommended that an increase in the petrol prices could be borne by vehicle owners
- They further identified that there is no substantial reason to further subsidize diesel, after carefully analyzing the diesel purchase pattern
- The report encourages taxation on car owners meant for private consumption that don't offer

high mileage, and additional excise duty on those vehicles

- Use of UID/ SMARTCARDS framework for effective distribution of domestic LPG
- Subsidies on domestic LPG should be discontinued except for BPL families
- Following the above recommendations under recoveries of OMC due to petrol and diesel will be nil

However, all of Dr. Parikh's recommendations did not see the light of day.

Arguments against the Commission Recommendations

On analyzing the given facts, what is the rationale behind the cost structure of individual petroleum products? For the sake of convenience we have assumed a dollar worth Rs 42 the price during the time period these recommendations were made.

India is heavily dependent on the import of crude oil, but it is not entirely dependent on foreign supplies of crude. About one-fourth of the nation's requirement comes from fields within the country. Indeed, the Oil and Natural Gas Corporation (ONGC) supplies its crude to Indian refiners at a discounted price of $55 a barrel. Logically, therefore, the weighted price of the Indian crude oil basket should be about $111.25 at a time when the international price is $130 a barrel. A barrel of crude is equal to 158.987 litres, which means that the weighted price of $111.25 a barrel implies that a litre of crude costs about 69 cents, or Rs. 29.39 a litre.

The cost of crude oil refining, which is essentially the process of converting crude to products such as petrol and diesel, varies a lot depending on a host of factors. But it depends critically on the grade of crude used and a refinery's vintage. Further while refining the cost of crude accounts for about 90% of the total cost. The refining margins are about 20 paise a litre to about Re. 1 for an old refinery. Thus, even if one uses the latter as the cost of conversion, the price of a litre of diesel and petrol would not be more than Rs. 30.39. Incidentally, both petrol and diesel cost roughly the same at the refinery gate; it is only the rates of duties that result in the differential in prices that consumers pay for the two.

Thus, before accepting the recommendations of the report a careful analysis of the taxation regime on petroleum products needs to be undertaken. Then only can a fair market driven pricing policy be adopted. The report only pays lip-service to the question of taxation leaving the same to the discussions on GST which are currently underway.

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