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Theme 201

OIL SHOCK AND ENERGY SECURITY

- PART - II

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Theme No. 201 : OIL SHOCK AND ENERGY SECURITY – PART-II

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**Is it true that retail fuel prices in emerging markets such as India are too low by global standards?**

The retail prices of petrol and diesel vary greatly across the world, reflecting the very different tax structures implemented by each country. Various tax components such as customs duty on imported crude, excise duties on refined fuel and sales taxes imposed by state governments constitute nearly 50 percent of the retail prices in India. When international prices increase, it becomes impossible to raise prices further accordingly owing to high tax content in the existing price structure. The Central and State governments are also unwilling to shell out tax revenues out of oil production and oil sales owing to fiscal constraints. The government is unable to pass on the sudden increase in global prices to the end-users because of inflationary concerns and unpopularity of the action. In the changed scenario, the government's fiscal dependence on an imported item such as crude and distillates whose prices are subject to wide fluctuations has to be reconsidered. The oil sector is the largest tax contributor to the central exchequer, paying close to Rs 70,000 crores on account of customs and excise duties. This is apart from the dividend they pay out to the government from profits. The same oil companies, however, are dependent on the government to remain in profit.

**What are 'Oil Bonds' and how do they act as subsidizing consumer prices?**

Oil Bonds are issued by Government of India in lieu of the payment due to the government owned oil companies on account of subsidized selling prices of oil to the public. In other words government undertakes to pay a portion of the cost on behalf of the public. Hence, it issues "Oil Bonds" to the companies in lieu of cash. Oil Bonds are issued with varying maturity periods and has a coupon rate associated with it. So, in real terms Oil Bonds are debts in government's balance sheet. Although, pricing of petroleum products was 'decontrolled' in April 2002 with the dismantling of the administered pricing mechanism, the government regulates prices of all major fuel at the retail level.

Oil Bonds can be traded in the secondary market which enables the oil companies owning the bonds to sell them off to the public/bank to raise cash. However these bonds are not liquid enough and the companies owning them find it difficult to liquidate them. By floating oil bonds the government is trying to convert short term revenue shortfall into long term bonds.

The mechanism of oil bonds was started more than a decade ago. The need for oil bonds, or any kind of subsidy, arises only because of the government's policy of keeping the consumer price of key distillates (diesel, petrol, kerosene and LPG cylinders) fixed over long periods of time in the face of rising international prices of oil.

Also, the government is not transferring oil bonds equivalent to the full amount of the OMCs' "under-recoveries" or the "price-control-caused losses". Only half is compensated by government through oil bonds, one-third by upstream oil producing companies such as ONGC, OIL and GAIL and the remaining is borne by the OMCs. "Under-recoveries" in 2008/9 are estimated to range between Rs 150,000 crores and Rs 200,000 crores.

The paradox of the current scenario is evident - the government imposes taxes (up to 50 percent plus on petrol and more than 30 percent on diesel) on the retail selling price of fuel. The tax increases the selling price of fuels. But the government then steps in to artificially control prices with a subsidy and to protect the consumer. This subsidy takes the form of special bonds called oil bonds, which often proves illiquid for the oil companies. So, on the one hand, while the oil companies are meeting their tax and dividend obligations, and on the other, they have to be bailed out through government bonds to remain profitable.

### **How are bio-fuels poised to impact fuel prices?**

Biofuels were once expected to become credible alternative to fossil fuels. Most of these technologies are still at laboratory stage. But there is now increased pressure to quickly move towards full commercial introduction of biofuels.

The recent record increase in prices of food grains and edible oil, which was attributed to decreased production due to diversion of farmland for bio-fuels is bound to affect productions of bio-fuels. Further, at today's high fuel usage levels, there is insufficient crop land to implement a wholesale changeover from petroleum to biofuels.

### **What is meant by ‘Energy Security’?**

Rising global energy demand poses a real and growing threat to the world’s energy security. Ensuring reliable and affordable supply of energy will be a formidable challenge. The Middle East, the transition economies, Africa and Latin America export more oil. All other regions – including China and India – have to import more oil. Energy security deals with making available sufficient clean energy that will sustain long-term economic growth.

### **Why is there a new search for alternatives to fossil fuels?**

Unchecked growth in fossil fuel use will hasten climate change, rising greenhouse-gas concentrations in the atmosphere. Urgent action is needed if greenhouse-gas concentrations are to be stabilised at a level that would prevent dangerous interference with the climate system. According to the best estimates of the Intergovernmental Panel on Climate Change, this concentration would correspond to an increase in average temperature of around 3°C above pre-industrial period levels. In order to limit the average increase in global temperatures to a maximum of 2.4°C, the concentration of greenhouse gases in the atmosphere would need to be stabilised at around 450 ppm. To achieve this, CO<sub>2</sub> emissions, which has already peaked by now, would need to be brought down substantially.

### **Will oil remain the most important source of energy?**

Fossil fuels continue to provide most of the world’s energy needs, with a share consistently over 85 percent. Oil has been in the leading position in supplying the world’s growing energy needs for the past four decades, and there is a clear expectation that this will continue. Gas is expected to grow at fast rates, while coal retains its importance in the energy mix. The total contribution of non-fossil fuels will grow. Despite the extreme high growth rates for some renewables, the rather low initial base makes the growth in absolute terms rather limited. There are many ways to create energy but all of them ultimately require more energy to create than is returned.

### **What is renewable energy?**

Renewable energy comes from energy resources that are continuously replenished through the cycles of nature. Unlike fossil fuels, their supply will never become exhausted. The main sources of renewable energy are: the sun (solar energy), the wind, moving water (hydropower, wave and tidal energy), heat below the surface of the earth (geothermal energy), biomass (wood, waste, energy crops).

### **What are the benefits of renewable energy?**

Renewable energy resources are clean sources of energy. They can be harnessed without damaging the environment, unlike using fossil fuels which release carbon dioxide and other harmful pollutants into the atmosphere.

Increasing the use of renewable energy is therefore a key strategy for reducing greenhouse gas emissions and meeting Kyoto Protocol commitments. Renewable energy resources will not become exhausted. Unlike finite fossil fuels, renewable energy resources are continuously replenished and will not run out. Renewable energy resources are indigenous resources. By increasing the use of renewable resources, we can achieve a more secure and stable energy supply for the long term.

### **How does renewable energy contribute to sustainability?**

Renewable energy is a supply-side solution for a sustainable energy economy. Renewable energy measures promote sustainability by increasing the supply of energy from sustainable sources and maintain economic growth without environmental damage. Energy efficiency measures promote sustainability by reducing demand for and consumption of energy.

### **Conclusion**

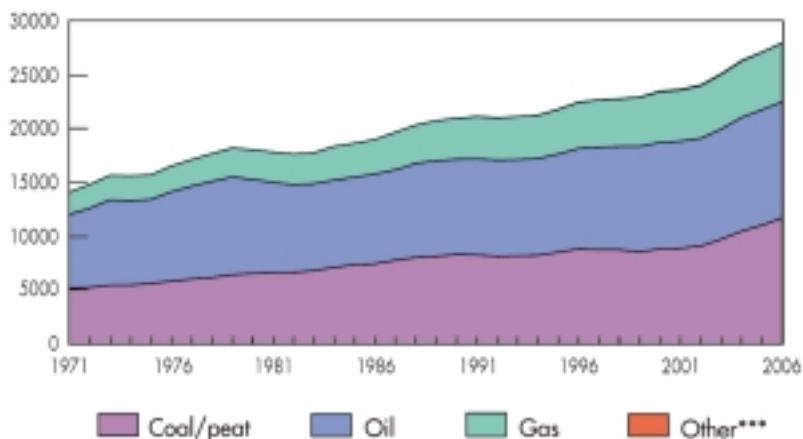
The price spiral of oil has coincided with the international efforts to control the demand for energy from fossil fuels. The energy ministers of G-8 countries have resolved to earmark more finance into the efforts to increase energy efficiency and develop “green technologies” with special interest in “Carbon Capture and Storage (CCS) schemes”.

With the world expected to rely on fossil fuels for many decades to come it is critical to ensure that future energy growth that supports both economic growth and social progress is compatible with tackling the issue of climate change. It points to the need to promote the early development and deployment of cleaner fossil fuel technologies. Carbon Capture and Storage (CCS) is a technology that could make a significant contribution to abate the growth of CO<sub>2</sub> emissions. The technology can be applied to large stationary sources of CO<sub>2</sub> emissions, such as power, cement and steel plants using coal fuel.



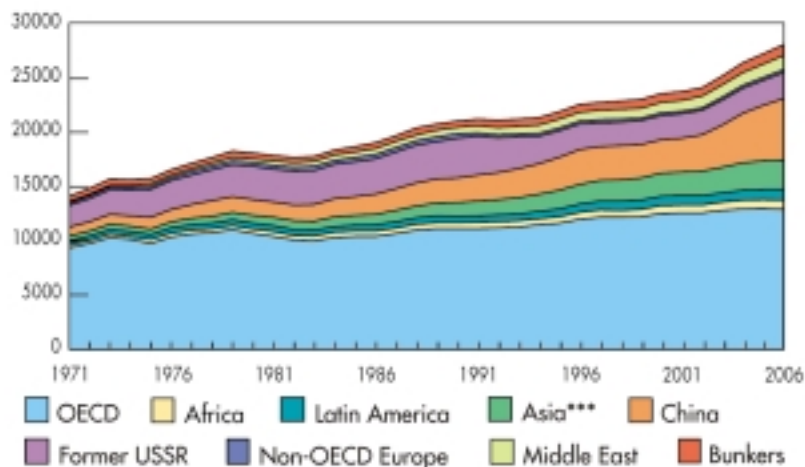
## CO<sub>2</sub> Emissions by Fuel

Evolution from 1971 to 2006 of world\* CO<sub>2</sub> emissions\*\* by fuel (Mt of CO<sub>2</sub>)



## CO<sub>2</sub> Emissions by Region

Evolution from 1971 to 2006 of world\* CO<sub>2</sub> emissions\*\* by region (Mt of CO<sub>2</sub>)



Source: International Energy Agency - World Energy Statistics, 2008



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