

Awareness of administered price mechanism in public



The topic of project is “ Awareness of administered price mechanism in public”.

The study was conducted into two phases, during the first phase a brief study of existing lubricant players were done. The marketing strategies and government policies for lubricant players were done. The secondary in terms of research papers and journals were collected and analysed to get a brief overview of the lubricant market and factors related to it.

In the second phase of the study a primary data collection from the people of Dehradun was conducted with the help of questionnaire. Primary Data collection was done to find out the awareness of administered Price Mechanism and pricing of petrol among Public.

Strategies like Price mechanism awareness campaigns for oil companies were formulated by analysing the awareness of Administered Price Mechanism among the customers.

With the help of the primary and secondary data some recommendations for government and oil companies were drawn which could help them to increase product satisfaction among customers who are not satisfied by the pricing of petroleum.

INTRODUCTION

Research Problem

Due to lack of transparency in Government pricing system public is not much aware about the mechanism behind the pricing of Petrol. This study is to find the level of awareness in the people.

Need For Research

There are many reasons of doing this research but the main reason is to understand the level of awareness in public about the administered price mechanism of petrol and to help them in understanding the advantages and disadvantages of administered price mechanism in petrol in India.

Recently, the term APM (administered pricing mechanism) dismantling has become a crucial issue which politicians, economists and oil/petroleum corporate bigwigs have discussed in detail. The term literally implies the removal of an administered pricing mechanism of petroleum products and a gradual shift towards a pricing based on pure market dynamics. This study will give a detailed knowledge of awareness of administered pricing mechanism in public.

Objectives

To analyse level of awareness in public on the basis of pricing and knowledge about the administered price mechanism of petrol in Dehradun.

To analyse the advantages and disadvantages of administered price mechanism in petrol for public.

Research Design Plan-

The research has mainly three objectives; the whole research work would revolve around it.

Primary Data Collection would be conducted by filling of questionnaire from Petroleum retail outlet customers of Dehradun.

Customers are normal consumer who owns a two wheeler or four wheeler vehicle.

Secondary Data Collection would be done for scanning the previous Awareness programs, to study prevailing government policies and factors supporting the awareness of public

Statistical Methods will be used to analyze, compare and draw conclusion.

The data presentation diagram like pie-chart, histogram, Line graph, Run chart, Control chart will be used to clarify all the objectives.

Sampling Technique- Random Sampling

Sample Size- 100

BACKGROUND

The country has traditionally operated under an Administered Pricing Mechanism for petroleum products. This system is based on the retention price concept under which the oil refineries, oil marketing companies and the pipelines are compensated for operating costs and are assured a return of 12% post-tax on net worth. Under this concept, a fixed level of profitability for the oil companies is ensured subject to their achieving their specified capacity utilisation. Upstream companies, namely ONGC, OIL and GAIL, are also under retention price concept and are assured a fixed return.

The administered pricing policy of petroleum products ensures that products used by the vulnerable sections of the society, like kerosene, or products

used as feed stocks for production of fertilizer, like naphtha, may be sold at subsidized prices.

Gradually, the Government of India is moving away from the administered pricing regime to market-determined, tariff-based pricing. Free imports are permitted for almost all petroleum products except petrol and diesel.

Earlier the prices were controlled by the government so there was the monopoly of the government to choose the right time for the prices to rise. Due to the political reasons the prices never used to rise before elections which resulted to huge losses to the oil companies and hence no private sector companies were willing to participate in the retailing of petrol.

Administered Price Mechanism

The price of a good or service as dictated by a governmental or other governing agency. Administered prices are not determined by regular market forces of supply and demand.

Examples of administered prices included price controls and rent controls. Administered prices are often imposed to maintain the affordability of certain goods and to prevent price gouging during periods of shortages (such as gas prices). Rent controls are intended to stabilize rent in certain cities, where rents are reviewed by a standard of reasonableness.

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Dismantling Administered Price Mechanism

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In recent years, the term APM (administered pricing mechanism) dismantling has become a crucial issue which politicians, economists and oil petroleum corporate bigwigs have discussed in detail.

The term literally implies the removal of an administered pricing mechanism of petroleum products and a gradual shift towards a pricing based on pure market dynamics.

How petro products priced before APM were was dismantled?

Prior to April 1, 2002 – after the implication of the new regime- domestic prices of some of the petroleum products were partially stable from changing international crude oil prices which is used as a raw material and certain products like kerosene and LPG (the domestic gas used in kitchen cylinders) were subsidised by the government.

The oil companies were told how much to sell and at what price.

The selling mechanism of the following four petroleum products used in India- petrol, diesel, kerosene and LPG.

Petrol

Earlier, by the control of government, petrol price was always higher than that of other fuels. Petrol prices have been kept at Rs 33 /litre whereas for diesel it stands at Rs 17 / litre.

Further, over the years, both petrol and diesel have been amongst the highest taxed of all commodities through state-related-sales tax and customs and excise duties.

All these factors have led to an overall higher consumption and usage for diesel compared to petrol. Petrol accounts for a sale of 9.3 m tonnes though margins on sale of petrol are higher than that of diesel.

The petroleum industry in India has been-closely regulated: the GOI (Government of India) has subjected each link in the chain – E&P (exploration and production), refining, marketing and distribution – to controls and checks. The oil crises of the 1970s were major drivers in prompting governments all over the world to intervene in the oil sector. The intervention was especially pronounced in oil importing countries such as India. As a result of the price hike, the Indian oil industry underwent a metamorphosis. The principle of import parity in pricing gave way to an APM (administered pricing mechanism) with an attendant command and control system. The need to ensure oil security led to the acquisition of foreign oil companies that virtually controlled the oil industry in the first half of this century. Notable among these were Burmah Shell, ESSO, Caltex, and Indo-Burmah Petroleum.

The rationale was that on their own, markets would not provide supply security or lead to socially desirable outcomes. Under the APM, all entities are assured a minimum return on their investments. -While the ONGC (Oil and Natural Gas Corporation Limited) and OIL (Oil India Limited) are allowed

a return of 15% on employed capital, the downstream companies get 12% (post tax) on their net worth.

Though there are incentives for exceeding the norms laid down by the OCC (Oil Coordination Committee), it is widely accepted that the system neither fosters innovation nor offers any significant incentive for efficiency. Some of the criticisms of the system are enumerated below. It puts a low premium on innovation and efficiency. It leads to non-optimal investment decisions that are not in conformity with market dynamics. Since the government controls product prices, political forces exert pressure on price levels. In the electricity sector, this has led to non-viability of most state electricity boards and in the oil sector, the result was an oil pool account deficit of 150 billion rupees. _ With an oil-gross domestic product elasticity of more than unity, India has been one of the world's fastest growing oil markets. Subsequent to the 1991 reforms, oil consumption has been growing at a rate of over six per cent. Although there has been a slowdown in the current year, India is still the fourth largest oil market in Asia with an annual consumption of over 85 MT (million tonnes).

The growth in demand is expected to be robust in the next decade and OCC projections indicate that demand will reach 155 MT by 2006/07. Meeting such a demand would require massive investment, far beyond the scope of the public sector. This calls for the involvement of the private sector, both domestic and foreign. Criticism of oil sector regulation and the need to attract private investment has caused far-reaching changes in the regulation of the oil industry. The objectives of this deregulation are outlined below.

Increase competition in the industry by allowing the entry of more players.
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Only a competitive market can spur oil companies to deliver value to consumers and ensure the international competitiveness and long-term survival of the Indian oil industry. Attract private capital which, in turn, requires that market forces be allowed to operate freely. Remove constraints on economic pricing of products and services to enable the industry to earn a reasonable return on investment.

1st April 2002 APM (Administrative Price Mechanism) was nationally dismantled to allow free hand to oil companies to import & market petroleum products in the country.

Major advantage of liberalization was flow of large amount of capital by private & foreign co's into the petroleum sector thus increasing the enormous infrastructure of refining (RPL & Essar import & marketing of), lubricant & petroleum gases by Caltex, Shell & other MNC's. Exploration by carion energy, IOC, RPL & few other MNC's

Though RPL & few other co's set up nearly 1400 retail outlets in the country, but the marketing operation was not successful due to alarming increase of crude oil prices in 2007-08, which could not be passed on to the consumers due to Government's indirect control in pricing thru' PSU co's which were compensated thru' oil bonds worth several thousand crores for keeping the prices under regulated controls due to political & socio economic compulsions of the Government.

Pricing Mechanism for petrol in India

Administered Price Mechanism was followed in India since April 2002 and then it was dismantled due to heavy subsidies which resulted in heavy losses to the Government of India.

Due to the Administered Price Mechanism the oil companies were going through heavy losses as the price of the petrol was less than the costs of the raw material ie. Crude oil and the operations by which it was produced.

The oil companies were under Government and hence they could not afford the losses and finally the dismantling of Administered Price Mechanism was performed to avoid the heavy losses of the company.

Earlier the prices were flexible and were in the hands of Government during the time of elections the prices were kept stable or even reduced to attract the public and this resulted in heavy financial losses to government.

It was and it is really a debatable issue that whether the petrol is Subsidised or taxed.

There are many articles by different authors showing the advantages and disadvantages of the Administered Price Mechanism in our country.

Awareness in Public

This whole system of subsidiaries and taxes was not properly published in public and hence the public is still not much aware about it.

Most of the people still do not know whether it is the Government who is controlling the prices or the companies. But today the prices are controlled by the companies. The prices are dependent on the crude prices.

Advantages:

Most of the advantages will be for government and for the Oil Companies.

When the subsidiaries are not provided to the government companies, the price of the petrol will reach the actual level of the market and hence many private companies can enter this market of petroleum and compete with the existing companies.

There will be no more losses to the oil companies as the prices will be controlled by them in a way to gain profits.

This will attract the heavy investments in the infrastructure by the foreign players which will be very helpful to the Government of India.

The financial power of the Government will be stronger as there will no subsidiaries needed for the losses of Government.

Disadvantages:

The price will increase rapidly with the increase in the price of the crude oil.

The Government of India will not be responsible for any increment in prices except for imposing more taxes.

Public may suffer due to high prices caused by removal of subsidiary help from Government

The current price of petrol is more than two times of the price which was during 2002.

LITERATURE REVIEW

According to Mr. Surjit S Bhalla, Facts regarding government policy are in short supply. The government of India claims that#Rs 71, 000 crore (Rs 710 billion) is needed to pay back the defaulted loans of poor farmers. No independent or quasi independent agency of the government has yet come out with the data matching this “ estimate” of the government.

The RBI figures on defaults by banks and co-operatives are close to Rs 30, 000 crore (Rs 300 billion); maybe it's time for the Finance Ministry to be sued under the Right to Information Act?

Inflation, the silent killer

Oil and energy facts are more important and more difficult to come by. It is claimed by all and sundry (government, oil companies, the market) that there is a net subsidy (under-recovery) of about Rs 225, 000 crore (Rs 22. 5 billion). And that the poor man's fuel, kerosene, was, until recently, being heavily subsidised.

Various facts about the market and domestic price of four energy items (kerosene, LPG, diesel and petrol) are presented for two different#assumptions of international oil prices: at \$80 and \$130 a barrel. The concern here is not what the net tax on oil should be; rather, it is whether the Gol oil policy is transparent.

Five major oil facts are interesting, if not revealing. First, and most unusually, the price of diesel in India is considerably below (25% less) the price of petrol; the world prices diesel at 20 per cent above the price of petrol.

Second, the consumer price of petrol in India is more than that in the US (at \$4. 40 a gallon), and among the highest in the developing world. In China, petrol is priced at only 74 cents a litre, compared to the average Indian price of \$1. 17 a litre.

World's costliest & cheapest petrol

Third, with oil at \$80/barrel, use of kerosene was being taxed by 5 per cent. Most people (including myself) believe that use of kerosene has been heavily subsidised.

Fourth, at \$80/barrel oil, the total tax gain to the economy was around Rs 91, 000 crore (Rs 910 billion); today, at \$130/barrel oil, the total loss (subsidy) is only Rs 25, 000 crore (Rs 250 billion) or only 0. 5 per cent of GDP.

Fifth, and finally, there is little sign of the 5 per cent of GDP loss figure (Rs 225, 000 crore), which is fashionably being touted around as the loss from our oil policy.

How is this patently false figure obtained? Via the oiliness of Indian policy, which is to first impose a tax on produced oil, and then sell it at a somewhat lower price, and then sell oil bonds to make up some of the difference!

At the end of it, no one knows whether there is actually a subsidy or a tax, and what its cost to the economy is. A numerical example can help illustrate. Assume international oil is at Rs 100; there is first a Rs 50 tax, then a Rs 25 subsidy. The government claims it is subsidising by Rs 25, when it is indeed taxing by the same amount! If this is not oily economics, I would like to meet the snake oil champion.

The figures presented are also disturbing. Why is there not much more scrutiny and discussion about the oily expenditures involved with other non-transparent government policies? Such expenditures are greater, and help the poor less.

But a greater problem might be that the government (RBI, Ministry of Finance, etc) may be making policy based on the certainty of \$130/oil for the next year when there is not enough evidence to warrant this conclusion.

One widely prevalent market view is that oil will be considerably higher than \$130 because of the inexorable demand from primarily the large populations of China and India. It is argued that a BIG reason for the price of oil to go up 600 per cent these last 10 years (the average price of oil in the late 1990s was \$20 a barrel) is because of India-China.

But these countries have been growing at a fast pace for the last 30 years, not just the last 10 years or just the last three months. So perhaps there is a bubble in the price of oil at \$130, given that all the markets, and the pundits, were pricing it at \$85 in February 2008, notwithstanding the hoopla of India and China.

It may be appropriate for investment banks and hedge funds to follow such risky strategies of everlasting increases in the price of oil; but the government of India?

An oil forecast based on India-China fundamentals is highly analogous to the recent speculative forecasts for the dollar/rupee made by these very same investment banks. It was argued, until just a month ago, that because India and China were both growing fast, their exchange rates would rise inexorably in the fashion envisioned by Led Zeppelin, Stairway to Heaven.

The rupee was forecast to be at 38 by end-2007, and then 36 and 33 soon thereafter. These talking-your-book investment banks did not bother to check that while China had a current account surplus of 11 per cent of GDP, India had a deficit of 3 per cent and a deficit which would become considerably greater if the rupee had gone to 38 or 33.

Today, the rupee is at 43, a good 12 per cent away from its highly “reliable inevitable” forecast. Given the volatility of the rupee, and oil, this ex-post error of the extrapolated forecast is just as huge as forecasting oil at 50 per cent away from its eventual value!

The point is simple; just because there is a fundamental at play, it does not mean that any forecast is reliable. Not all stairways go to heaven, not all forecasts come true.

Indeed, given the extraordinary spike of oil, a 50 per cent rise in the past three months, a prudent government, or investment bank, would play a waiting game for the market to “stabilise” – just as the prudent

investor#would/should have done when the US dollar was on its lows at Rs 39.

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As Mentioned in [http://economictimes.indiatimes.](http://economictimes.indiatimes.com/news/politics/nation/CPM-wants-APM-for-petrol-back/articleshowNEW)

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DELHI: With public sector oil companies increasing petrol prices twice over the past month, CPM has asked the Manmohan Singh government to scrap deregulation in petrol pricing. “ By deregulating petrol pricing, the government has opened the way for successive hikes in prices,” CPM polit bureau said in a statement issued here. CPM said the rise in fuel prices will further add to inflationary burden on the people at a time when they were suffering from “ continuous food inflation”. Alleging that there was no transparency in the decision making, CPM said it opposes the recurrent increase in the#prices of petrol. Pointing out that the public sector oil companies have increased the price of petrol by 70 to 72 paise per litre, it said this followed an increase of 27 paise per litre in September.

“ The price of petrol has already been increased by `1 per litre in the space of three weeks,” according to the party statement. The government had in June 2010 freed petrol pricing from its administrative control allowing the state-run oil marketing companies to fix rates in line with cost of production in the recommendations of the Kirit Parikh Committee. The price increase reflects an average revenue loss on petrol since then. Though diesel price is

also deregulated on paper, the government has not yet empowered state-run companies to fix its price fearing its political aftermath.

After the announcement of deregulation in June, petrol prices went up by `3.50 a litre and diesel by `2 a litre. The government had asked its oil firms to hold the price line for petrol, fearing opposition attacks during the monsoon session of Parliament.

The Left had opposed deregulation of petrol pricing apprehending it will add to the inflationary pressures.

According to Ms. Sonal Thankur, The Empowered Group of Ministers (EGoM) finally mustered up the courage to free fuel prices from the administered price mechanism (APM), in spite of huge political pressure. In April 2002, the government had completely dismantled the APM. However, due to a surge in crude oil and petroleum product prices since then, the government had to again take control. Regulation of petroleum prices resulted in huge losses for three entities. These include the upstream oil companies (namely ONGC, Oil India), the petroleum refining & marketing companies (including IOCL, HPCL & BPCL) and the government. The government subsidised the essential petroleum products in the form of cash or oil bonds to PSU petroleum refining companies.

The panel of ministers said petrol prices would be market driven, rising Rs 3.50 per litre, while kerosene prices would rise by Rs3 a litre. Diesel prices will rise Rs 2 per litre and will be freed up in the future. Cooking gas prices were raised by Rs 35 a cylinder.

The retail selling prices of petrol and diesel in Mumbai will increase to Rs 55. 4 per litre and Rs 41. 6 per litre, #respectively in Mumbai. Prices of LPG (for domestic use) will rise to Rs 347 per cylinder while kerosene under PDS will be available to retailers at Rs 12 per litre.

According to Petroleum Secretary S. Sundareshan, the price hike is likely to result in Rs 23, 600 crore reductions in under-recoveries of oil marketing companies to about Rs 56, 500 crore in 2010-11. This#will boost the profitability of the companies. However, it will also result in inflationary pressures on the Indian economy.

Reliance Industries, which operates the world's biggest refining complex at Jamnagar, is expected revive all its pumps, which were shut down five years ago when the government started subsidising fuel sold by state firms.

Freeing up of petrol prices is not likely to have a severe impact on automobile sales in the near term. However, if the price of crude oil in the global market moves up sharply, we may see demand getting adversely affected. Rise in price of diesel is likely to result in higher freight rates as diesel prices account for nearly 55-60% of the total cost of a transporter. Crisis Research estimates freight rates to go up by around 3-4 per cent following the hike in diesel prices.

As by Prasanna P. Vaidya, In India fuel prices are controlled by government. Although government announced the dismantling of Administered Price Mechanism (APM) effective 1st- Apr-2002 in order to move towards market determined prices for petroleum products, it has not taken off its hands from determining fuel prices. This intervention even after dismantling APM was <https://assignbuster.com/awareness-of-administered-price-mechanism-in-public/>

due to unprecedented rise in crude prices since late 2003. Oil marketing companies (OMCs) such as Indian Oil, Bharat Petroleum & Hindustan Petroleum, which deal in refining & marketing activities of petroleum products, sell auto fuels & cooking fuels below prevailing international market prices.

Estimates say OMCs will have under-recoveries of around Rs. 45, 000 Cr in this financial year assuming crude oil at \$70 per barrel. Out of this Rs. 15000 Cr will be on account of Auto Fuels (Petrol-Diesel), Another Rs. 17000 Cr will be due to Kerosene & remaining Rs. 13000 Cr will be shaved off on account of LPG. Indian Oil (IOC), Hindustan Petroleum (HPCL) and Bharat Petroleum (BPCL) lose Rs 4. 69 per litre on petrol and Rs 3. 09 a litre on diesel. They sell LPG at a loss of Rs 158. 55 per 14. 2-kg cylinder and kerosene at Rs 17. 15 per lit loss.

These under-recoveries will be reimbursed in part by government in the form of oil bonds which would cover losses incurred due to Kerosene & LPG. So government has to issue oil bonds worth Rs. 30, 000 Cr to OMCs. Some part of losses will be shared by upstream (e. g. ONGC) & downstream (IOC, BPCL, HPCL) companies. Government will try to offset losses of OMCs on Auto Fuels by asking companies like ONGC to sell crude oil & LPG to retailers (OMCs) at discounted rates. Still part of losses has to be taken care of by OMCs. Some help will come from Rs. 3109 Cr which is provided under the head of Petroleum Subsidy in union budget 2009-10.

Now let's look at the other side of the saga. Government earns huge tax revenues from petroleum products in the form of customs as well as excise

duties. In FY2008-09 total tax revenues earned from petroleum products was Rs. 78373 Cr. If we assume those to be more or less on similar lines for the year 2009-10 as well then government seems to be in green. Tax rates in India on Petroleum Products are irrational. Petrol is highly taxed. Around 50% of the petrol price is made up of taxes if central sales tax & state sales tax are taken into consideration.

Diesel taxes are relatively lower in comparison with Petrol. Around 30% of its price will be on account of various taxes. This is the prime reason for diesel consumption to have leapfrogged in India. Diesel forms 85% of the total consumption of auto fuels. Taxes on Kerosene & LPG form a tiny part of their prices. It has been so due to the government's perception of kerosene & LPG as household's cooking fuel – more precisely a fuel of poor people.

So can Government of India continue with such kind of pricing in future? Is it sustainable? Let's look at it – Pricing of these products has always been a political issue than an economic one in India. Those having reins of the country always find it difficult to increase the prices as it has been considered as an unpopular measure. Some feel it will lead to an increase in prices of primary articles leading to a spiraling inflation. Many governments have reduced the prices when elections were just around the corner in order to cash in votes.

Governments have set up many committees to formulate a strategy for pricing of petroleum prices, recommendations of which have been hardly implemented. With fiscal deficit looming large at 6.8% of GDP, is India in a position to continue such kind of Fuel subsidies? Government is set to borrow

around Rs. 4, 00, 000 Cr from market to power its various initiatives. Such kind of mammoth borrowing will definitely lead to increase in interest rates. This will in turn affect capital expenditure plans of corporate sector as they will not get capital at lower rates. It will impede employment generation to some extent.

De-regularization of fuel prices will help in reducing the ballooning fiscal deficit. Issuing oil bonds to OMCs was thought to be a financial innovation as it facilitates OMCs to cover up their losses & government is not required to pay upfront money as well. But it is anybody's guess that government has to pay interests on the bonds issued plus at maturity principle amount also has to be returned back.

Consider this as your children paying taxes for the petrol or LPG you have used. Does this sound rational by any means? The answer is big NO. Why Indian citizens should pay back, for fuels which we are using now, after 10 years? Is it because we should get fuels at discounted rates? Do people who really require subsidies get any help by all this? Why people driving Mercedes & BMWs should get subsidies? Going forward – Why Indian middle class should get LPG at a discount of 158 Rs? Let's churn this aspect out – Let's consider a household of 4 members with earnings of 15, 000 Rs. per month. How much burden it will be on such households if LPG cylinder is made available at market prices? Is 158 /- Rs. such an enormous amount?

Just imagine how much government can save through this. The way people having higher incomes do not get anything through Public Distribution Systems, they will not get LPG at subsidized rate if they fall in high income

group. Government just needs to check pan cards of the gas applicants. I really don't see any major hurdle in implementing this. Pyramid like subsidy structure can be followed for LPG if required. High the income lower will be the subsidy burden. Now let's focus on petrol & diesel. Petrol & diesel prices are pretty much nearer to market prices. So those can be made fully in line with prevailing rates. But government has to shun its control from dictating prices to OMCs.

OMCs should be given a total freedom to increase & decrease the prices at par with international prices. For e. g. when crude oil was boiling at 140 \$ per barrel, government intervention to increase fuel prices came too late. At that time OMCs were losing around Rs. 500 Cr a day. Such kind of losses affects health of the OMCs.

They cannot go ahead with their expansion plans because of uncertainty of under-recoveries. If government de-regularizes these products even private players will come to the fore in retailing business. Then eventually we may get fuels at little lower rates due to competition. Refining companies like Reliance will try to sell products in India because they don't have to export the same to get free market prices since selling in domestic markets will reduce their freight charges.

De-regularization will automatically impact the demand of these products. It is said that people in India are poor so they are entitled to get subsidies. Simple statistics shows that fuel consumption increases with rise the per capita income. Subsidies are not targeted at people who are really poor because they are not using fuels in large quantities.

Rich people use more fuels & more subsidies they get. This is not what government intends, Right? No one likes hike in commodity prices. Human tendency is to use resources available in nature as tools to achieve economic progress. But the way we look at commodities needs to change a lot. These commodities are not available in unlimited quantities. There are going to be supply constraints in future. With current consumption rate we will consume all fossil fuels by 2040. We have not found fuels which can replace them. India imports 80% of its fuel needs.

There is a need to maintain austerity. For e. g. If prices are made market driven then people who just manage to maintain cars may shift to pub