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Gasoline and Diesel Pricing Reforms in the BRIC Countries:
A Comparison of Policy and Outcomes

Executive Summary

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Recent changes in international oil prices have highlighted the issue of petroleum product pricing reforms in a number of non-OECD economies, particularly as the non-OECD now accounts for the bulk of the global growth in consumption of petroleum products. In 2014, non-OECD oil demand is predicted to overtake OECD oil demand for the very first time. Of this, four economies – Brazil, Russia, India, and China, the 'BRIC' countries – will account for 45 per cent of the non-OECD countries' total oil demand.

The BRIC countries have some common socioeconomic and demographic characteristics, and also face similar challenges in domestic energy policy. One significant common policy stance has been associated with the domestic pricing of petroleum products – specifically, the historical use of price controls to protect households from changes in the international oil price and to prevent rising energy prices from feeding into general inflationary pressures, together with efforts to reform these price controls over time.

Recent fluctuations in international oil prices have posed challenges in this regard. These fluctuations, combined with the often arbitrary manner in which policy instruments have been used for maintaining price controls to shield consumers from their impacts, have meant that the effects of changes in the international oil price are felt elsewhere in these economies – for instance, on the finances of the National Oil Companies (NOCs), and on the fiscal deficit.

The most interesting feature of this shared policy stance on price controls and pricing reform is that it has led to different outcomes in the BRIC economies, particularly in relation to downstream investment. This implies that there are factors within the BRICs that have brought about different outcomes for each country's reform processes – processes that are arguably similar in their original policy objectives.

This paper investigates the impacts of gasoline and diesel pricing reforms on downstream investment in the BRICs; it sets out the reform process, draws out these factors, and analyses the impact of domestic pricing policy specifically in terms of its outcomes on investment in the downstream petroleum products sector.

Of the four 'BRIC' economies India and China (the two countries that are the largest net importers of oil) have accounted for the largest downstream investments and expansions in refining capacity. However, these are also the two economies where price controls for petroleum products have been retained by governments, which have preferred a gradual approach towards the deregulation and liberalization of prices. In contrast, Brazil and Russia, where petroleum product prices were officially liberalized in the early 1990s and early 2000s, have experienced serious constraints in attracting downstream investments and have struggled to expand (in the case of Brazil) or upgrade (in the case of Russia) their refining capacity. These outcomes run counterintuitive to expectation, according to which price liberalization and the alignment of domestic petroleum product prices with international oil prices should be conducive to fostering competition and investment along the entire value chain.

In investigating the reasons for this counterintuitive outcome, an analysis of the 'pass-through' of international price movements to domestic prices for gasoline and diesel shows broad evidence of price controls being exercised in Brazil and Russia despite the official liberalization of prices, through implicit or indirect measures, with governments typically influencing domestic pricing through intervention in the operations and capital expenditure plans of the NOCs. In contrast, governments in India and China have used explicit or direct measures such as setting prices directly, adjusting federal taxes, and compensating NOCs and marketing/retailing companies as well as specific consumer groups affected by price changes directly using cash transfers.

The findings therefore demonstrate a dichotomy of experience amongst the BRICs. While in Russia and Brazil, prices were officially liberalized, implicit price controls were re-imposed primarily through the NOCs. As Russia is a net oil exporter by a comfortable margin, the impact of this strategy on the finances of Rosneft has arguably been less adverse than it has been on Petrobras. In the cases of China and India, price controls were retained by the government, with gradual liberalization. Although the impacts on Chinese and Indian NOCs were negative for a long period, their finances have gradually improved following targeted efforts by their governments on price deregulation.

The experiences of the BRIC economies highlight three important lessons. The first is that the impacts of price controls generally tend to be concentrated in one part of the value chain which governments may view as 'manageable' or 'containable' – given that most state-owned oil companies are vertically integrated and there is the perception that they can survive in unprofitable sectors. But these impacts, have a knock-on effect, as shown in this paper. The knock-on effects in Brazil and Russia relate primarily to investments in refining capacity. However, in India and China, although government support has contributed to the expansion of refining capacity, the knock-on effect of price controls is evident; in India, private sector investment in petroleum product retailing was crowded out, and in China independent (teapot) refiners have taken the hit.

The second lesson relates to the fact that petroleum product price liberalization is not irreversible – demonstrated by the experiences of Brazil and Russia where price controls were reintroduced implicitly. The continued success of the Chinese and Indian governments' recent price reforms will depend on their ability to sustain them in the long term.

Following on from this, the third lesson relates to the need, post-liberalization (particularly in the case of Brazil and Russia), for policies and price adjustment mechanisms which are both coherent and transparent, and which take into account the potentially negative impacts of price controls on downstream capital expenditure. This ideally necessitates a resolve by governments not to implicitly intervene in NOCs' capital expenditure plans to the detriment of their finances, and to instead institute a compensation scheme targeted directly at consumers.

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