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A Review of Petrol and Diesel Pricing Policy in India

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ABSTRACT:

India the pricing of petroleum products plays an important role in its economy as more than 75 per cent of consumption of crude oil in India is based on import, and the world market price of crude is highly volatile. The present petroleum products pricing policy of the OMCs threatens the healthy development of petro-retail sector and growing burden of under-recoveries, which put stress on government finance due to subsidies provided on it. It is also observed that though the prices of petrol and diesel has been deregulated from 2010 onwards leading to a market determined pricing regime, the decrease in crude oil prices have not lead to a corresponding reduction in motor fuels in India. Hence, there is no symmetric relationship between crude oil price and prices of petrol &diesel after the deregulation of prices which indicates that these OMC's are using similar cost of distribution and the same margin to determine the price to charge the dealer. So the objective of this paper is to review the present pricing policy of Petrol & Diesel in India and the challenges pertaining to the present pricing policy.

INTRODUCTION

In India the pricing of petroleum products plays an important role in its economy as more than 75 per cent of consumption of crude oil in India is based on import, and the world market price of crude is highly volatile. The present petroleum products pricing policy of the OMCs threatens the healthy development of petro-retail sector and growing burden of under-recoveries, which reached an all-time high of Rs.1,38,541 crore in 2011-12, which put stress on government finance due to subsidies provided on it. As the major share of the Indian petro-retail market structure is in the hand of the public owned OMCs which makes it concentrated market. These oil companies dragging international prices into domestic pricing structure whereas under-recovery is not equal to loss for the oil companies. Oil companies follow the pricing policy that is unfavorable to consumers.

It is also observed that though the prices of petrol and diesel has been deregulated from 2010 onwards leading to a market determined pricing regime, the decrease in crude oil prices have not lead to a corresponding reduction in motor fuels in India. Hence, there is no symmetric relationship between crude oil price and prices of petrol &diesel after the deregulation of prices which indicates that these OMC's are using similar cost of distribution and the same margin to determine the price to charge the dealer. This is very serious evidence of anti-competitive practice.

The recent deregulation initiatives by the government of India has aimed at making the prices of petrol completely deregulated i.e. market determined and the prices of diesel being partially deregulated. This policy initiative has been aimed at providing opportunity to the private players to compete on prices against this public sector. But the public sector OMCs are trying to create a barrier by blocking the sites to guard their monopolistic grip on petrol pumps, by setting up pumps at 16,000 sites which would entail a total investment of around Rs 6,000 crore. Around 16,000 retail outlets of petrol pumps which are partially not operating because of the abnormality in the market place. Private players have far that before the decontrol of fuel prices is implemented they might wash out from the market. The criteria of investment 20,000 million in exploration or refining or pipeline or terminals act as an entry barrier and restrict small players from entering the market.

The collusive pricing policy of the oil companies is an anti-competitive practice and also come under the radar of the competition commission in the past as the limited number of players in this sector working as a leverage for these companies. Due to absence of level playing field, high real estate prices, multiple approvals & huge investments make not viable for private players to compete in the market. Due to not viable opportunities in the domestic market the private sectors oil companies nearly half (80 million tons) of their output exported outside the India. The standalone entities/refineries processing petrol, diesel and LPG, but did not have exclusive retail outlets for selling of their products they have to dependent on the state oil marketing companies. They needed strong marketing support to survive. To achieve this, government of India needs to attract investment in the oil sector which is possible by sending right price signals which can be achieved through development of a vibrant, liquid and an efficient petro-retail market. In this paper the author review the present pricing policy of petrol and diesel used by Indian Oil Marketing Companies (OMC's) and its inverse effect of customer's in terms of right prices.

PRICING OF PETROL AND DIESEL IN INDIA

As far as the prices of petroleum products are concerned, there are a number of factors responsible for influencing petroleum prices like - cost of crude oil, demand and supply imbalances, taxes and duties on petroleum products and market conditions, production and consumption of petroleum products, petroleum reserves, imports of petroleum products, international prices of petroleum products, subsidy on petroleum products, and locational effects, etc.

Historical Perspective of Petroleum Pricing

The history of oil pricing can be traced back to the late 1920s when the private companies were marketing imported products mainly kerosene. No authority either the government or the companies enforced any artificial control on the prices.

Valued Stock Account

The first attempt to regulate the oil prices was based on Valued Stock Account (VSA) procedure agreed to between the Government of India and Burmah Shell in 1948. The VSA was based on

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import parity formula according to which the basic selling prices of all the major petroleum products were determined as the sum of Free on Board(FOB) price, ocean freight , insurance , ocean loss , import duty, interest and other charges as well as 10 per cent remuneration. Burmah Shell as market price leader maintained separate VSAs for each product.

In 1958, VSA was terminated following the decision of the Government that the basis for pricing of petroleum products should be actual costs with some reasonable profit. But the first systematic attempt to regulate the prices of petroleum products was based on the recommendations of the Dalme Committee in 1961.

Administered Pricing Mechanism

On 16 March 1974, the Government appointed Oil Prices Committee (OPC) under the Chairmanship of Dr. K. S. Krishnaswamy. In November 1976, the OPC recommended discontinuance of the Import Parity Pricing System and also introduction of a pricing system based on domestic cost of production. Their recommendations led to the dawn of Administered Pricing Mechanism (APM). The system implemented by OPC recommendations was later modified by the Oil Cost Review Committee (OCRC) in 1984. These modifications as approved by the Government allowed continuance of the APM recommended by OPC.

The APM continued through the late 1970s, 1980s and mid- 1990s. But the explosive growth in the late 1990s required the Government to call for funds from private and international investors. The ability of the oil companies to generate investible surpluses were reduced considerably by the APM which allowed returns of the depreciated net fixed assets. Accordingly, the Government in 1995 set up an Industry Study Group whose report formed the main input for the Strategic Planning Group on Restructuring of the Indian Oil Industry5. The group found major deficiencies of APM in making the domestic petroleum sector viable and globally competitive. According to the group, APM could not generate sufficient financial resources for oil companies to make the required investment for energy security. APM was finally dismantled in March 2002 and operationalization of market determined pricing mechanism was notified.

During April 2002 to January 2004 oil companies changed the domestic consumer prices of Petrol and Diesel and Domestic LPG based on market factors. However, Kerosene price was not changed. The period from 2004 to 2008 witnessed three distinct policy phases to address oil price volatility:

i. Price Band Mechanism- Under the system, the government gave limited freedom to oil marketing companies to revise retail prices within a band of +/-10 per cent of the mean of rolling average of last 12 months and last 3 months of international Cost and Freight(C&F) prices. As oil prices rose sharply and there was uncertainty in international oil markets, the Price Band Mechanism was abandoned.

ii. Trade Parity Pricing- In October 2005, the Government constituted the Rangarajan Committee which recommended a formula of Trade Parity Pricing (TPP) for petrol and diesel at refinery level as well as at retail level. The formula was a weighted average of import parity and export parity prices, in which the percentage share of import/ export of these products provided the weights in the ratio of 80:20.

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iii. Burden Sharing Mechanism to meet OMCs under-recoveries. This mechanism involved PSU upstream oil companies which extended hefty price discounts on their sale of crude oil to the OMCs, and the Government which issued bonds every year. Continuance of such an arrangement became unsustainable.

In 1976, India nationalized the refining and marketing sector in response to the oil crisis of the 1970s and introduced regulatory controls on production, imports, distribution and pricing of crude oil and petroleum products. The Oil Coordination Committee was formed to act as a regulatory body in this regard. As per the de-regulation policy, the Indian oil sector is scheduled to be completely deregulated from April 2002 in all aspects of pricing, imports and exports of crude and petroleum products. Under the liberalization policy, a number of structural changes have already been effected in form of the private sector being allowed to carry out refining as well as marketing of a limited number of petroleum products e.g. LPG, naphtha, Aviation fuel, fuel oil etc(Dasgupta, 2011).

PRESENT POLICY ON PRICING OF PETROLEUM PRODUCTS

On 31 August 2009, the Government constituted an Expert Group under the Chairmanship of Dr. Kirit S. Parikh to examine the current pricing policy of the four sensitive petroleum products namely Petrol, Diesel, PDS Kerosene and Domestic LPG and to advise on a viable and sustainable system of pricing petroleum products. Based on the recommendations of the Expert Group and decisions taken in the meeting of the Empowered Group on Ministers (EGoM), the Government decided that

(i) The prices of petrol both at the refinery gate and the retail level, will be made market determined effective from 26 June 2010

(ii) The prices of diesel will also be made market determined both at the refinery gate and at the retail level. However at the initial stage the retail selling price of diesel was increased by Rs. 2/litre at Delhi effective from 26 June 2010 with corresponding increases in the rest of the country

(iii) The retail selling prices of PDS Kerosene and Domestic LPG will be increased by Rs. 3/litre and Rs.35/cylinder effective from 26 June 2010 at Delhi respectively with corresponding increases in the rest of the country

POST DEREGULATION PRICE MOVEMENTS

On 26 June 2010, the prices of petrol are market determined both at the refinery gate and retail level and partial deregulation on diesel prices. Now the prices must be determined on market level, but there is no consistency in petrol and diesel prices when compared with the international crude prices due to anti-competitive practices of state-owned Oil Marketing Companies (OMC's) increasing or decreasing the price of petroleum products in tandem (Dutta, 2013).

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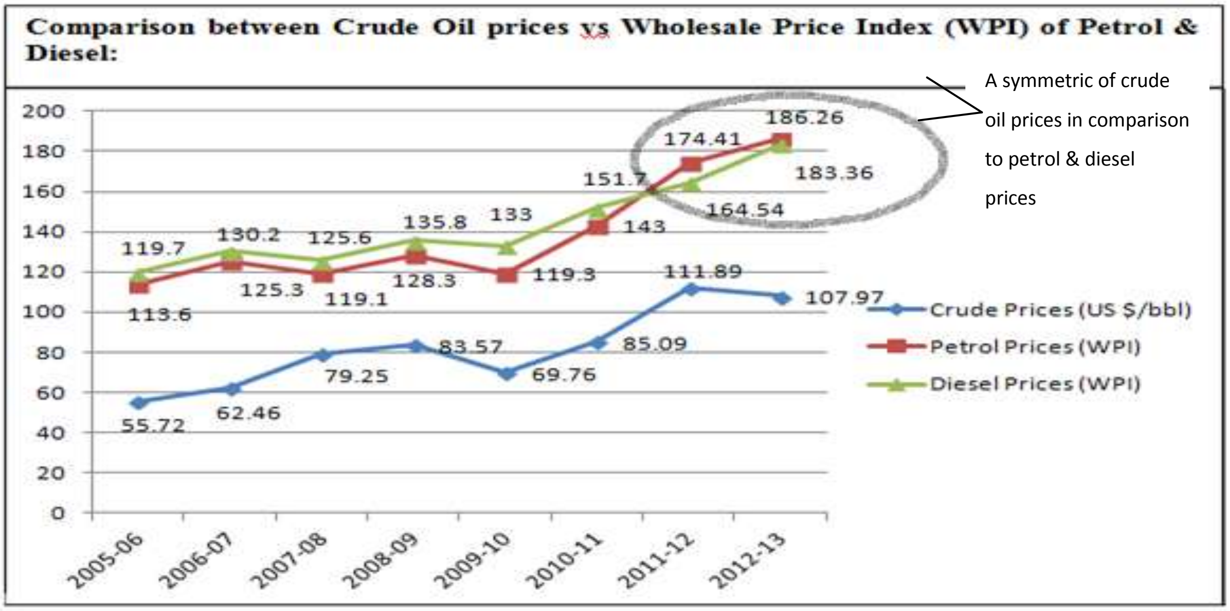
Figure 1: Post Deregulation Price Movements



Source: Indian Petroleum & Natural Gas Statistics 2012-13, GOI, MoPNG

As figure (Fig 1) depicts that there is no symmetric relationship between crude oil price and prices of petrol &diesel after the deregulation of prices which indicates that these OMC's are using similar cost of distribution and the same margin to determine the price to charge the dealer. This is very serious evidence of anti-competitive practice. This also indicates that the companies have been exchanging information on costs of production.

Government of India forced state-owned companies to sell petroleum products at below cost due to which these companies suffered revenue losses on the sale of products. These losses termed as 'under-recovery' which was shared by the Government of India and up-stream oil companies (Singh S. K., 20013). But a closer look at Indian petrol price build up reveals that the so called under-recovery of OMC's are notional and exaggerated due to inclusion of non-existing cost, these under-recoveries a fiscal burden for Government of India as well as for up-stream companies. It acts as a barrier to private players from entering the market because, unlike the state-owned OMCs, the government won't bear the compensation burden for them (Gosh, 2013). To compensate these under-recoveries Government of India provides subsidies to the state-owned OMC's. The growing burden of under-recoveries, which reached an all-time high of Rs. 1, 38,541 crore in 2011–12. Apart from encouraging inefficiency in the use of petroleum products due to the subsidies offered, these under-recoveries have many other consequences. They put stress on government finances (Parikh, 2013).The OMC's been claiming under recover and has been getting subsidies to recover the claim loss.

The OMCs have reported the following under recovery during 2012-13 & April-Dec 2014:

Table 1: Under-recovery 2013-14

Product	2013-14 (9M) (₹/Crore)	2012-13 (₹/Crore)
Diesel	47,655	92,061
PDS Kerosene	22,373	29,410
Domestic LPG	30,604	39,558
Total	1,00,632	1,61,029

Source: Petroleum Planning & Analysis Cell

The total loss of OMCs from selling petroleum products for the year 2011-12 was claimed to be a colossal Rs 1,32,541 crore. After taking the subsidy of Rs 1,38,718 crore paid by the government and upstream oil and gas companies, the profit-loss account of OMCs for the same year shows a cumulative net profit of Rs 6,177 crore. It is possible that unleashing the forces of petro-retail forces would bring domestic prices even below the export parity prices (Ghosh & Prasad, 2012).

India is a net exporter of petroleum products, the appropriate cost price for the oil retailer at the refinery gate should be Export Parity Prices (XPP), the price that oil companies would realize on export of a petroleum product. A shift to XPP would have cut the subsidy on diesel by Rs 14,372 crore in 2012-13. Private participation should further reduce XPP and, hence, under-recovery figures, as private players are better than their state-run counterparts in refining in terms of superior technologies, hedging strategies, high-sea deals in crude procurement and strategic coastal locations. There is need to discourage under-recovery by encouraging competition and break down the apparent cartelization among Indian OMC's (Gosh, 2013). Present pricing policy is unfavorable to the customer as well as to the market which leads to the following challenges.

Petrol & Diesel Pricing (Challenges)

Oil companies dragging international prices into domestic pricing structure. Oil companies follow the pricing policy that is unfavorable to consumers (Srinivasan, 2012). The pricing of petroleum products is important because more than 75 per cent of India's consumption of crude oil is based on imported products, and the world market price of crude is highly volatile. The present petroleum products pricing policy of the government threatens the healthy development of oil companies. The growing burden of under-recoveries, which reached an all time high of Rs.1,38,541 crore in 2011-12. They put stress on government finance. Under-recovery is not equal to loss for the oil companies. It is important to have rational prices for all the petroleum products. Maintaining a level playing field between the public and private sector firms as well as public sector firms is desirable to promote healthy competition (Parikh, 2013).

The price of fuels in India is governed by trade parity pricing (TPP), comprising of 80% import-parity price (IPP) and 20% export-parity price (XPP) at the refinery gate. The non-existent price build-up does not stop here. Charges like customs duty and import charges are further added to the IPP price. In India, the retail price of petroleum products, other than petrol and aviation turbine fuel (ATF), is administered and is much lower than TPP. The gap between the TPP of a petro-product like diesel at the refinery gate and its administered price is termed as under-recoveries or losses. A closer look at the price build-up of diesel reveals that the so-called under-recoveries of OMCs are notional and exaggerated due to the inclusion of non-existent costs like trade premium, ocean freight charges, customs duty and import charges in calculating TPP. XPP is lower than the TPP (Ghosh, India's sham fuel pricing regime boosts subsidies, 2013).

EPP is lower than TPP by $5.1/bbl for diesel and $3.1/bbl for LPG/SKO. From the government's point of view the change in pricing methodology to EPP from trade parity (TPP) will immediately chop off nearly Rs 15,000-20,000 crore from the annual petroleum under-recovery number. As a result, the government will end up paying less to the three oil marketing companies (Kashelkar, 2013).

The oil companies adopt a strange pricing policy that is linked neither to their costs nor to the competition in the market. The oil companies simply take the price of petrol in the Singapore market, apply the rupee-dollar exchange rates to that price, add other costs such as freight and import duties and lo, there comes the price that they should charge domestic consumers. The collusive pricing policy of the oil companies is an anti-competitive practice and has come under the radar of the Competition Commission in the past. India need a strong dose of reform in the form of freeing of pricing of petroleum products while simultaneously encouraging competition (Srinivasan, What goes down will surely go up, 2012).

CONCLUSION

A viable long-term strategy for pricing major petroleum products is required. A major objective of policy is to have an efficient and competitive oil economy that promotes efficient use by consumers, appropriate choice of fuels among substitutes and a proper choice of technique. This is best ensured by a competitive energy sector. Price control, subsidies and taxes can introduce distortions which may not be desirable. Petrol prices should be market-determined both at the refinery gate and retail levels. The price of diesel should also be market determined both at the refinery gate and retail levels. A market-determined pricing system for petrol and diesel can be sustained in the long-run by providing level playing field and promoting competition among all players, public and private, in the oil and gas sector.

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