Need for Cost–Plus Pricing in Petroleum Industry

Why in news?

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In Indian cities the retail prices of petrol and diesel have risen to new high.

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What is the status of increasing petroleum prices?

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- The hike in petrol and diesel prices are attributed to the steadily increasing price of international crude oil.
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- The share of Petrol and diesel out of total indirect tax revenues increased significantly after international crude oil prices started declining from the middle of 2014.
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- The Union and states took advantage of the lower prices to increase excise duty and sales tax on petrol and diesel, respectively.
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- Now there is demand for rolling back these duties as the crude oil prices have begun rising.
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- However, conceding the roll back can be disastrous for the fiscal situation of the Union and the states.
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What factors determine the fuel costs?

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- **Market factors -**The price is determined by the movement of crude oil price (the main raw material), the rupee/dollar exchange rate and demand-supply situation in the market.
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- **Excise duty-**There was a series of excise duty hikes in the second half of 2015 and the initial months of 2016 on both petrol and diesel to help shore up finances.
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- This has helped the Centre realise higher central excise duties will fetch higher revenues.
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- **Oil companies -** Oil companies have the pricing freedom and Government has no business interfering in the day-to-day affairs of the companies.
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What are the issues with current system of pricing?

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- Daily pricing of petrol and diesel linked with market was introduced in keeping with international practices.
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- This current system of pricing is based on trade parity, assuming 80 per cent of petrol and diesel is imported and 20 per cent is exported.
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- At many instance companies buy crude oil at high price and they sell it for low price due to market trends, to match this losses they hike the prices.
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- This system is no longer relevant as the country does not import any of these products and this system confers undue benefits to private sector refiners on their sales of petrol and diesel in the domestic market.
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What measures can be taken to resolve this issue?

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- The only way there can be a reduction of taxes on petroleum products is by including them in the GST regime.
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- This is difficult to be implemented in the short run considering the undue shock to the revenues to the Centre and States.
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- Hence, it would be more relevant to allow oil refiners to price their products based on their costs of refining, a reasonable rate of return and marketing overheads.
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- This will introduce an element of competition among different oil refiners and allow more efficient and transparent price discovery for these products.
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Source: Business Standard

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