New formula for reducing fuel costs

What is the issue?

\n\n

Union government, to reduce the retail prices of petrol and diesel can work on with cost plus formula.

\n\n

What are the issues with trade parity?

\n\n

\n
- At present, the government is following the trade parity formula for pricing the fuels, which is based on international markets.
\n
- By this, price for a commodity or service is pegged to another price or to a composite average of prices based on a prior selected period.
\n
- The formula based on trade parity fixes the landed cost of petrol and diesel at a level that is slightly higher because of the inclusion of customs duty in it.
\n
- The logic of an 80 % weight in favour of imports in the formula is questionable, with negligible imports of petrol and diesel taking place at present.
\n
- It also discourages oil refining companies from achieving greater operational efficiency since their cost of petrol or diesel is pre-determined by a formula irrespective of their actual refining costs.
\n

\n\n

What is cost plus pricing formula?

\n\n

\n
- It is now necessary to move away from the pricing formula based on trade parity and embrace a cost-plus pricing system.
\n

- Cost plus pricing is a cost-based method for setting the prices of goods and services.
  \n
- Under this approach, one can add together the direct material cost, direct labour cost, and overhead costs for a product, and add to it a mark-up percentage (to create a profit margin) in order to derive the price of the product.
  \n
- Cost plus pricing is a relatively simple mechanism and easy to understand.
  \n
- It will also introduce transparency and help reflect a more reasonable and correct picture of the oil companies' under-recoveries.
  \n
- It, in turn, could help reduce the government's subsidy bill and even reduce retail fuel prices.
  \n

\n\n

\n\n

Source: Business Standard

\n

