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All about Fuel Pricing

What is the issue?

- Petrol and diesel prices hit a two-year high in mid-December 2020. Petrol is well above Rs. 80 a litre while diesel is getting there.
- The fact that crude oil - the fountainhead of these fuels - is still below 2018 levels highlights the role of petrol and diesel pricing policies of the government.

What is the fuel pricing mechanism?

- The price of petrol and diesel in India is not determined by the actual costs incurred by PSU refiners.
    - These include crude oil sourcing, refining and marketing costs incurred by Indian Oil, HPCL and BPCL.
- Rather, a formula named the trade parity price (TPP) is used to price these products.
- It assumes that 80% of petrol and diesel is imported into India and 20% is exported.
- So, petrol and diesel prices in India are determined based on prices of these fuels in the international market and not on the basis of crude oil prices.
- The international petrol and diesel prices generally move in line with crude oil prices.
- But it need not always be the case, given that demand and supply dynamics could be different.
- The TPP in dollars is converted to rupees. Then comes other costs and margins of the oil companies, dealer commission and taxes.
- From mid-June 2017, the pricing of petrol and diesel is done through a ‘daily pricing’ mechanism, based on a 15-day rolling average international rate.
    - So, time lag has an effect too.
- Further, the weakening of the rupee against the dollar over the years has added to the fuel’s cost.

What role do taxes play?

- Petrol and diesel are government’s good source of revenue.
- During the crude crash earlier in 2020, a cash-strapped Centre raised excise duty on petrol and diesel by Rs. 13-16 a litre.

- Many States too increased their sales tax/VAT.
- But when oil prices started rising, the taxes were not rolled back.
- So fuel prices increased, and customers bore the brunt.
- Notably, taxes now account for about 60% of the fuels' price.
- Besides pricing mechanism and taxes, there are unexplained pauses to price changes, leading to opacity in pricing.
    - E.g. For more than 80 days between March and June 2020, the fuels' prices were frozen when they should have actually fallen.

What are the concerns?

- India imports most of its oil needs but is more than self-sufficient in petrol and diesel production.
- So, the trade parity pricing mechanism has often been criticised, especially since petrol and diesel are 'decontrolled' fuels.
- The complaints include allegations of cartelisation with the three PSU oil companies charging nearly the same price, despite different cost structures and efficiencies.
    - Cartelisation means a group of industry participants coming together to fix pricing of products and services. This may work against the interest of consumers.
- Transparent pricing, based on market principles, will likely help consumers more.

What is the significance?

- Higher petrol and diesel prices don't just mean higher personal transport costs.
- They could also cause a price spike in a host of goods and services, given that these fuels play a big part in running the economy.

Source: BusinessLine