Pricing mechanism behind petroleum

What is the issue?

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Petroleum prices are rising and there are considerable demands to the centre to reduce its excise duties on the product.

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How the sector was deregulated?

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- Being a basic intermediate good, it is operated through a special oil pool account funded by the surplus of ONGC and the refining companies, as well as direct government subsidies.
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- Being an ideal commodity for indirect tax, high Central excise duty and high sales tax rates by the states at the retail level were levied.
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- With the rising trend in international crude oil prices the subsidy burden of the oil pool account began to mount.
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- There were demands that the oil market should be deregulated.
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- But the excise revenues from oil was substantially larger than the subsidies provided by the centre.
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- Also, the surpluses of petroleum mining and refining companies were substantial enough for cross subsidisation of the loss-making retail oil companies.
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- But the entry of private players like Reliance and Essar into the retail trade made cross-subsidisation untenable.
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- Thus the administered Price Mechanism for petroleum was dismantled and market pricing mechanism was allowed.
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What was the consequence?

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- The Centre chose to increase the excise duty on petrol and diesel, although OPEC prices showed a downward trend.
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- The hike in excise duty was 380 per cent for diesel and 120 per cent for petrol between 2014 and 2017.
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- The **C&AG Report** has observed that the huge increase in central excise collection from petroleum products (2015-16) was due to a sharp increase in per unit tax on petrol and diesel.
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- The excise duty revenue of the central government from petroleum products which was Rs.88600 crores in 2013-14 peaked to Rs.2,53,254 crores in 2016-17.
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- Never has indirect tax on any commodity witnessed such a sharp escalation as on petroleum products.
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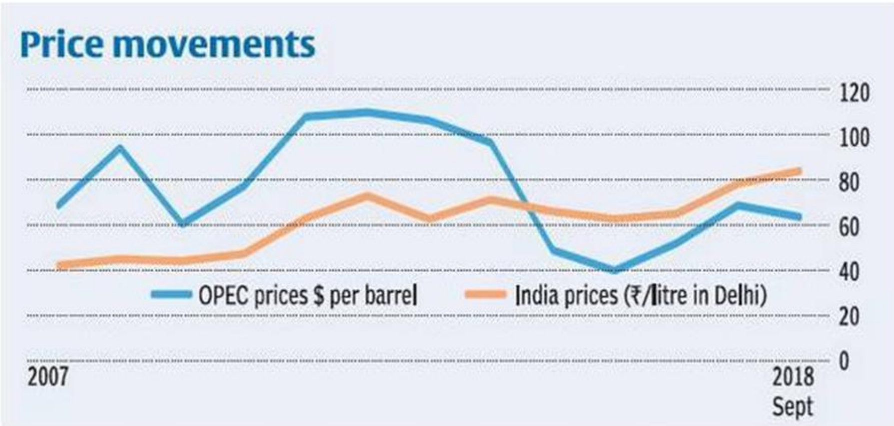

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What is the present scenario?

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- The international prices crude oil began to rise from late 2016.
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- Yet the Centre refused to reduce the excise duties and prodded oil

companies to raise their retail selling prices.
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- The Centre fears an adverse impact on fiscal deficit, if any additional revenue from petroleum productsgets lost.
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- The depreciating rupee also added to their woes.
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- However, rising fuel prices are stoking an inflationary fire and imposing an unbearable burden on the people.
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Should the states be held responsible?

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- States are benefiting from petroleum price escalation through higher devolution after the 14th Finance Commission award in the share of central excise duty.
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- However, **only basic excise duty** on petrol and diesel is shareable with the States and others are outside the divisible pool of taxes shareable with the States.
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Duty structure (₹ per litre)

Item	Basic excise duty	Special excise aduty	Additional excise duty	Total	Share of basic excise duty in total (%)
Petrol	7.66	6	7	20.66	37.07
Diesel	10.69	6	1	17.69	60.42

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- Also, VAT rates has been hardly increasedin recent years and even some states have already reduced VAT rates to moderate the current price escalation.
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What should the centre do?

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- The centre argues that it keeps a substantial portion outside the shareable pool for its obligations on social sector spending.
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- There is no established connection between higher duties on petroleum products and social sector spending.
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- A demand has also been made that petroleum products be included in the GST.
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- But before it gets into reality, a compensation package has to be finalised as per the GST compensation law.
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- This would make the present compensation cess to be inadequate.
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- Thus the solution is for the Centre to immediately roll back its excise duty spikes.
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Source: Business Line

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