Chapter 4 Conclusion and Recommendations

A. Conclusion

The mechanism of pricing petroleum products has evolved from cost plus mode (Administered Price Mechanism) to import parity and now to a combination of import parity and trade parity pricing. As per the pricing methodology, the price at the refinery gate is set above the FOB price of the product at the chosen destination which allows a higher return to the refineries. This benefit is available to all refineries including private and stand-alone refineries. However, OMC refineries have inherent drawbacks in terms of vintage, uneconomical size and location with the result that the benefit does not fully accrue to these refineries.

The pricing mechanism at the refinery gate was intended as an incentive for upgrading the technology of existing refineries and to attract investment in the refinery segment for improvement of efficiencies. While OMCs have made some investments in their existing refineries for technology up-gradation, study of a sample indicates that there is still a significant gap in the performance of these refineries and there is a need for further technology upgradation. Expenses related to marketing included in the price build up also do not reflect the actual expenses incurred by OMCs.

The price buildup leads to under-recoveries of OMCs which are funded partly by GoI and partly by upstream companies. Funding of under recoveries has adversely affected the upstream companies who bear over a third of the under recovery burden, while the delay in and mode of settlement of under recovery claims have in turn, adversely affected OMCs. Under recoveries also contributed to a higher fiscal deficit of GoI. Besides, absence of a formal, well-defined mechanism of sharing under recoveries contributed to a degree of uncertainty detrimental to the interests of both upstream companies and OMCs.

Taxation contributes significantly to the RSP of products paid by the end consumer. Central and State taxes together account for 19 *per cent* of the RSP of HSD at Delhi (August 2012). While Central taxes have been periodically rationalized, the State taxes varied widely and at ad-valorem rates which placed a higher burden on consumers with increasing product prices. Rationalization of State taxes along with a transition to an integrated tax regime with tax payable on value added at each stage of operation is yet to be achieved.

Amount of under recovery on petroleum products nearly doubled from ₹77,123 crore in 2007-08 to ₹1,38,541 crore in 2011-12 even after deregulation of MS in June 2010. GoI has taken some steps to address the issue. A system of dual pricing of HSD, with bulk customers paying full market price, has been implemented effective January 2013. This has, however, led to a reduction in sale to bulk customers. Subsidized LPG cylinders have been limited to nine (since increased to 12 in February 2014) and transfer of direct benefit to the consumers using 'Aadhar' platform is being implemented on a pilot mode in selected districts. The impact of these recent initiatives would take time to be clearly established.

B. Recommendations

1. Continuance of protection in the pricing mechanism of major petroleum products was intended to improve efficiencies and encourage appropriate investments in technology up-gradation in PSU refineries which has not been fully achieved. Though MoPNG has advocated continued support to these refineries through the pricing methodology, there is a strong case for review of this mechanism in view of the limited progress in improvement of the efficiencies of refineries (as evident from Audit test check) and consider an alternate transparent, target oriented mechanism in the case of poorly performing refineries.

2. GoI may in the meantime, put in place a formal and transparent burden sharing mechanism among all stakeholders (up-stream companies, OMCs and GoI) instead of the present *adhoc* system of compensation of under-recoveries so that the compensation is received in time and OMCs do not face crunch of working capital.

3. GoI may ensure that the pricing mechanism does not unduly benefit private/stand alone refineries through the existing practice of compensation for domestic supplies to OMCs at rates higher than their export realization.

4. GoI may revisit 'LPG (Domestic) and SKO (PDS Kerosene) subsidy scheme 2002' to reflect more accurately the under-recovery/subsidy requirements for LPG and SKO and ensure that such amounts are budgeted for in the respective years.

5. GoI may pursue achievement of rationalization of State taxes on major petroleum products and transition to an integrated tax regime with tax payable on value added at each stage of operation in a time bound manner.

New Delhi
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