PETROLEUM PRICING POLICY OF GOVERNMENT OF INDIA

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INDTRODUCTION

Petroleum is a very important source of energy for the primary, secondary and tertiary sectors of the economy as well as for the household sector. From a mere 1.2per cent in 1950-51, the contribution of oil and gas to total primary commercial fuel production in India has increased to 33 per cent in 1990-91. The percentage share of oil and gas in the commercial energy consumption, on the other hand, was as high as 43.4 in 1990-91, the gap being filled through large scale imports. Oil is also the direct source of asphalt, waxes and lubricants and is the raw material for thousands of chemicals which find their way into our daily lives in the form of medicines, cosmetics, paints, plastics, fertilizers, insecticides, etc.

Petroleum product pricing in India is frequently seen as a black hole of subsidies. Economists and oil companies complain about the impacts those subsidies have on public finances, financial performance of oil companies and demand-side management. However, on closer analysis, the issue of petroleum product pricing in India is more complex than the one-way flow of subsidies that is mostly reported. The artificially low prices of petrol and diesel, however, do not reflect the realities of the high crude and refined product prices. These low prices offered to the public are subsidized by the government through the issuance of oil bonds, which are given exclusively to public sector fuel retailers in India.

Objective of pricing policy

Pricing policy should promote economically efficient allocation of resources. It would require that the relative fuel prices should influence the pattern of consumption in the direction of least-cost mix of energy resources to meet future demands. However, there may be other socioeconomic objectives which may suggest deviations from economically efficient prices. One such objective may be **to meet the basic energy needs of the poor sections of society at prices which they can afford.** .. ..Some other objectives may be control of inflation, encouragement of domestic resource-use, security of supply, profitability of public sector units and environmental considerations.

On the international scene, oil is perhaps the single most important economic commodity. It accounts for the greatest share of world trade, provides the mainstay of the world's largest companies, is the dominant force in the determination of energy prices and plays a major part in international power politics. Because of these very factors, the oil industry is also subject to the highest degree of uncertainty. But, in spite of the important place oil holds in the Indian economic scene, successive Governments at the Centre have seldom attempted to formulate a meaningful long term policy on Petroleum. There is urgent need for formulating such a long-term policy taking into account the international politics of oil, India's own production potential, socio-economic considerations involved in the pricing of various products, need for oil conservation etc. Economic logic requires that the Government adopt pricing policies that ensure optimum utilization of the resource, but political compulsions often tend to result in a pricing policy at loggerheads with economics. Successive committees of experts have recommended modifications in the right direction, but the Government tends to defer pricing reforms till they run out of options. Presently, attempts are being made by the Ministry of Petroleum and Natural Gas to open up the oil sector and to use pricing as a means of sustaining economic growth in a competitive environment, care being taken to ensure that the deprived sections of society are not further burdened by these reforms. This is an arduous task fraught with serious socio-political repercussions.

Ramesh Bhatia in his address to the Tata Energy Research Institute Workshop on Energy policy issues (July 1984) stated the problem in a nutshell thus:

In a free- market economy, energy prices act as an allocative mechanism by providing appropriate signals to the consumers and producers. In a developing country, the role of prices may depend on a number of stated policy objectives and the special characteristics of energy demand and supply. The objectives of energy pricing are related to the goals of macroeconomic policy and goals of energy planning. The objective of economic development would require that pricing policy should promote economically efficient allocation of resources. It would require that the relative fuel prices should influence the pattern of consumption in the direction of least-cost mix of energy resources to meet future demands. However, there may be other socioeconomic objectives which may suggest deviations from economically efficient prices. One such objective may be to meet the basic energy needs of the poor sections of society at prices which they can afford. .. ..Some other objectives may be control of inflation, encouragement of domestic resource-use, security of supply, profitability of public sector units and environmental considerations.

In their eagerness to meet the multiple objectives, the Government have to adopt different policies at different points of time. Some of them may stand the test of time; some may turn out to be harmful to the economy. In India, at the time of independence, there was a need for the Government to exercise strict controls on this very important natural resource, but it took more than a decade for the nascent nation to come to grips with the complexities of the industry and start exercising controls. Over the last few decades, with the Indian petroleum industry and the Indian private enterprise coming of age, the situation has changed. Presently, there is perceived need for opening up the sector for private investment including foreign capital and technology. Of all the policy instruments available to the Government, pricing is perhaps the most efficacious as it directly affects investment decisions, producer consumer relations and the state of the economy. In this context, a comprehensive study of the various issues related to the petroleum pricing policy of Government of India assumes considerable significance.

Silent features of the Government policy and objective

1. Pricing policy at the time of independence and the changes brought about as a result of the recommendations of successive oil price committees,

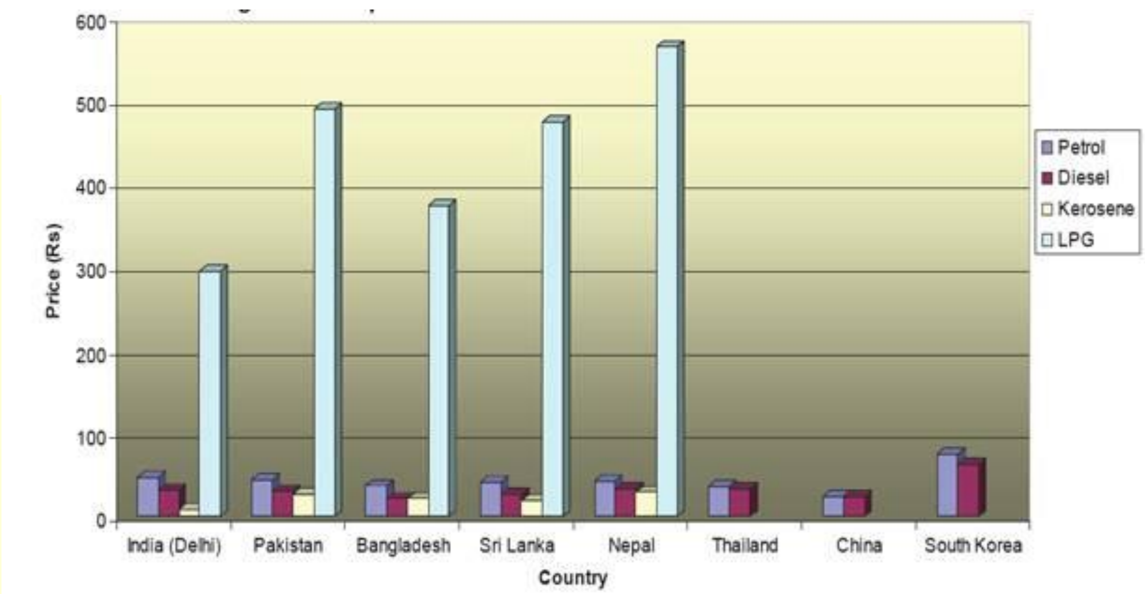
2. The impact of pricing policy on the consumption of oil products, its effect on demand - supply imbalance,
3. The impact of international developments on oil prices,
4. Product pricing mechanism followed at present,
5. Economic principles of pricing of crude oil, natural gas and finished products,
6. The current thinking on pricing policy, and
7. Alternative approaches to pricing and recommended choices.

Pricing policy and makes an attempt to evaluate the reasons that led to the policies adopted by the Government of India at different points of time and their impact on the national economy. The study the pricing policy of the Government is also makes an earnest effort to identify future policy options. Since any policy that determines the price of oil and oil products. Influenced by policies governing exploration, refining, marketing, import - export and petroleum conservation, this study also analyses these policies in so far as they have a bearing on the pricing policy. Due to limitations imposed by the magnitude of each aspect of Petroleum policy, the study has not tried to cover all these aspects in detail. Maintaining its focus on pricing policy, efforts have been made to trace the evolution of the petroleum policy of Government of India from 1947 till date, the factors both national and international that influenced these policies, possible alternatives that were available to the Government and the consequences of the choices made by the Government. Critical analysis of such policy decisions both from administrative and economic points of view has been attempted. These analytical studies have been made in the light of the world oil scenario existing at the relevant time.

Currently, the refinery gate prices of petroleum products are computed based on the Import Parity Principle. In the computation of import parity prices, the principal elements are the FOB price, customs duties, ocean freight and a few other associated items. These elements, except for the FOB price, are not relevant in computing export parity prices.

With the dismantling of APM from April 2002, oil companies stand exposed to the vagaries in the international prices of crude oil and products. Hence, their profitability is now governed by different set of factors. Post-APM dismantling, import of oil, mainly from the Gulf countries, has become a serious threat to domestic players.

Comparison of Retail Price in Selected Asian Countries



Source: Rangarajan Committee Report

Petroleum Pricing Policy in India -Need for Change

India is one of the fastest growing economies of the world. At the same time, the country is also home to almost one fifth of the total world population. With such a huge chunk of the world population and growth rate of the economy hovering around 8 to 9 per cent per annum for last five years, the demand for the petroleum products is expectedly high. Keeping the social and economic ramifications in mind the government has always remained involved with the pricing and supply of these products.

The reasons for the direct involvement of the government are not difficult to seek. While the demand for the petroleum products is rising by almost 15 per cent per annum, the domestic production of the crude oil has virtually remained stagnant over the last two decades, making the country heavily dependent on the import of crude.

Further, the rapidly developing economy requires petroleum products like diesel and petrol in huge quantities for carrying goods across this vast country. Diesel is also used by many industries as a critical input for production. The booming automobile sector of the country also needs a lot of petrol and diesel at reasonable prices. Thus, any steep increase in the prices of oil adversely affects the Indian economy.

The most important aspects of oil policy, namely the pricing policy and makes an attempt to evaluate the reasons that led to the policies adopted by the Government of India at different points of time and their impact on the national economy.

The Alternative

The logic behind the extent of increase in prices is neither understood by the general public and nor is transparent. Under the current scenario, where the crude oil prices are fluctuating with upward trend, the pricing mechanism has become even more suspect.

CONCLUSION

Since any policy that determines the price of oil and oil products is influenced by policies governing exploration, refining, marketing, import - export and petroleum conservation, this study also analyses these policies in so far as they have a bearing on the pricing policy. Due to limitations imposed by the magnitude of each aspect of Petroleum products.

Outline of a Recommended Pricing Policy

- Crude prices should be brought at par with international prices and the public sector exploration companies should devote their surpluses for further development of the oil fields and for evolving exploration techniques suited for Indian offshore and onshore. The present practice of charging fixed rates of royalty and cess should be replaced by ad valorem duties to provide incentives to producers for cost reduction.
- Natural gas should be priced at par with the price of the equivalent crude oil in terms of calorific value, taking into account transportation costs.
- All the refining companies including privately owned ones may be allowed to import crude oil and natural gas directly at negotiated prices in order to take advantage of price fluctuations in the international market. They should also be free to export their products in excess of any contractual obligations.

- Customs duty on imported crude and products should be rationalized to make crude import no less remunerative than product import, so that the refining sector will remain viable in the long run.
- In the present economic scenario, there is a strong case for free market pricing. The Administered Pricing Mechanism (APM) needs to be replaced by a Market Determined Pricing Mechanism (MDPM) with selective Government intervention.
- The present retention pricing which is biased in favour of inefficient refineries should be replaced by pricing products ex-refinery at levels determined by international prices.
- Any rational approach towards pricing policy should eschew subsidies as they have a tendency to distort price signals. Such distortions lead to uneconomic consumption and are anti-conservationist. Price subsidies for kerosene, HSD and LPG, if considered inevitable from social equity point of view, should be substituted by direct subsidies and subsidies on equipment.
- It may not be possible to introduce all these measures in the immediate future; particularly the deregulation of products such as kerosene and diesel may pose formidable problems. Therefore, it is desirable that deregulation is effected in phases, starting with the pricing of products which are not of mass consumption, such as fuel oil, LSHS and naphtha, and marketing of these products.
- Even if exploration, refining and marketing are deregulated, the major share in each 01- these operations will continue to be with the oil PSEs, which will enable the Government to retain strategic control on the entire petroleum industry. This strength should be utilized direct the course of deregulation.
- Even after the marketing companies are freed from the clutches of APM, they should be subject to strategic control by a regulatory body to ensure availability of oil products in the remote areas of the country.
- A price monitoring system should be set up at the Ministry level with industry participation to prevent monopolistic practices and to ensure supply in every region.

Maintaining its focus on pricing policy, efforts have been made to trace the evolution of the petroleum policy of Government of India from 1947 till date, the factors both national and international that influenced these policies, possible alternatives that were available to the Government and the consequences of the choices made by the Government. Critical analysis of such policy decisions both from administrative and economic points of view has been attempted. These analytical studies have been made in the light of the world oil scenario existing at the relevant time. It was expected that the new pricing mechanism would be the first step to move forward towards a pricing mechanism based on the interaction of the market forces.

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