6

STANDING COMMITTEE ON PETROLEUM & NATURAL GAS (2004-05)

FOURTEENTH LOK SABHA

MINISTRY OF PETROLEUM & NATURAL GAS

PRICING OF PETROLEUM PRODUCTS

SIXTH REPORT

LOK SABHA SECRETARIAT
NEW DELHI

August, 2005/Sravana, 1927 (Saka)

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CP&NG NO. 6

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Presented to Lok Sabha on 04.08.2005

Laid in Rajya Sabha on 04.08.2005

सत्यमेव जयते

LOK SABHA SECRETARIAT
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COMPOSITION OF THE STANDING COMMITTEE ON PETROLEUM & NATURAL GAS
(2004-05)

Shri N. Janardhana Reddy - Chairman

Members

Lok Sabha

2. Shri Anandrao Vithoba Adsul
3. Dr. Rattan Singh Ajnala
4. Shri Ramesh Bais
5. Shri Kirip Chaliha
6. Shri Lal Muni Choubey
7. Shri Tushar A. Choudhary
8. Shri R. Dhanuskodi Athithan
9. Shri Santosh Kumar Gangwar
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11. Shri Ch. V.H. Rama Jogaiah
12. Shri Suresh Kurup
13. Shri Sukhdeo Paswan
14. Dr. Prasanna Kumar Patasani
15. Shri Laxman Singh
16. Shri Rajiv Ranjan Singh
17. Shri Ramji Lal Suman
18. Shri Vanlalzawma
19. Shri Ratilal Kalidas Varma
20. Shri Rajesh Verma
21. Shri A.K.S. Vijayan

Rajya Sabha

22. Shri Ahmed Patel
23. Shri Moolchand Meena
24. Shri Rajeev Shukla
25. Shri Kripal Parmar
26. Shri M. Rajasekara Murthy
27. Shri Dipankar Mukherjee
28. Shri C. Perumal
29. Dr. Alladi P. Rajkumar
30. Shri Subash Prasad Yadav
31. Shri Satish Chandra Misra

Secretariat

1. Shri John Joseph - *Secretary*
2. Shri S.K. Sharma - *Additional Secretary*
3. Shri P.K. Grover - *Director*
4. Shri P.C. Tripathy - *Under Secretary*
5. Smt. Reena M. Jacob - *Committee Officer*

INTRODUCTION

I, the Chairman, Standing Committee on Petroleum and Natural Gas (2004-05) having been authorised by the Committee to submit the Report on their behalf present this Sixth Report on 'Pricing of Petroleum Products'.

2. The Committee took evidence of the representatives of the Ministry of Petroleum and Natural Gas and the concerned Public Sector Undertakings at their sitting held on 11th January , 2005 and 21st June, 2005. The Committee also took evidence of Shri H.L Zutshi, ex-CMD, HPCL on 16th February, 2005 and Shri U. Sundararajan, ex-CMD, BPCL and Shri B.C. Bora, ex-CMD, ONGC on 5th May, 2005.

3. The Committee considered and adopted the Report at their sitting held on 1st August, 2005.

4. The Committee wish to express their thanks to the representatives of the Ministry of Petroleum and Natural Gas and Public Sector Undertakings for placing their views before them and furnishing the information desired in connection with examination of the subject.

5. The Committee also wish to express their thanks to the Non-official witnesses for placing their considered views on the subject before the Committee.

6. The Committee also place on record their appreciation for the invaluable assistance rendered to them by the officials of the Lok Sabha Secretariat attached to the Committee.

NEW DELHI;
August 1, 2005;
Sravana 10, 1927(Saka)

N. JANARDHANA REDDY,
Chairman,
Standing Committee on
Petroleum & Natural Gas.

REPORT

PART - I

CHAPTER - I

EVOLUTION OF PRICING IN THE HYDROCARBON SECTOR

(A) Historical Perspectives

1.1 The history of oil pricing can be traced back to the late 1920s. During this period, the private companies were marketing imported product - mainly kerosene. No authority, either the Government or the companies, enforced any artificial controls on the prices, which were allowed to float. This situation continued till the advent of the second world war. During the war and post war periods (1939-1948), the oil companies maintained price pools for major products.

1.2 The first attempt to regulate the oil prices was based on Valued Stock Account (VSA) procedure agreed to between the Government of India and Burmah Shell in 1948. The VSA was based on import parity formula with Ras Tanura as the basing point. According to this system, the basic selling prices of all the major petroleum products were determined as the sum of Free on Board (FOB) Ras Tanura price, ocean freight, insurance, ocean loss, import duty, interest and other charges, as well as 10% remuneration. Burmah Shell as market price leader maintained separate VSA's for each product. Other companies followed the prices fixed by Burmah Shell. At the end of each year, collections at provisional basic selling price were set off against actual costs. The resultant surplus/ deficit were certified by Auditors and advised to Government. The selling prices were adjusted accordingly to keep the account in balance.

1.3 In 1958, VSA was terminated following the decision of the Government that the basis for pricing of petroleum products should be actual (not assumed) costs with some reasonable profit. Subsequently, from 1st April 1959, a new ad-hoc arrangement was entered into following the examination of the price structure of the petroleum products by the Chief Cost-Accounts Officer, Government of India. But the first systematic attempt to regulate the prices of petroleum products was based on the recommendations of the Dalme Committee in 1961.

1.4 Various pricing committees appointed by the Government during the 1960s including the Dalme Committee (1961) and Talukdar Committee (1965) advocated fixing of prices of petroleum products on import parity basis as the bulk of the crude oil and major petroleum products were being imported into the country from West Asia. But the Shantilal Shah Committee (1969) which examined the whole issue de-novo felt that the Import Parity basis did not constitute the proper basis for fixation of the prices of petroleum products, as indigenous crude oil production and refining capacity had become a considerable factor by that time. Nevertheless, they recommended the continuance of import parity in view of the Government of India's commitments to the foreign oil companies in terms of `refinery agreements'.

(B) Administered Pricing Mechanism

1.5 On 16th March, 1974, the Government appointed Oil Prices Committee (OPC) under the stewardship of Dr. K.S. Krishnaswamy, the then Executive Director, Reserve Bank of India. In November, 1976, OPC recommended discontinuance of the import parity pricing system and introduction of a pricing system based on domestic cost of production. Their recommendations have led to the dawn of Administered Pricing Mechanism (APM) .

1.6 The major reasons cited by OPC for a complete move away from import parity pricing to APM were as follows:-

- The import of products constituted less than 10% of the total demand of the country and with the continued increase in the domestic refining capacity, the share of imported products was expected to come further down.
- The export of products from Middle East constituted only about 5% of the total export of crude oil and products and hence, the posted price of the products did not reflect prices appropriate to Indian conditions.
- There was a time lag in the response of products posting to the changes in the crude prices and also that the posting of all the individual products did not move in unison.
- There was no unique system of stable Crude Prices which could be linked to a set of posting of individual products.
- The import parity principle did not take into account the inter refinery differences in respect of type of crude oil, production pattern and size complexities of the refineries.

1.7 The system implemented by OPC recommendations was later modified by the Oil Cost Review Committee (OCRC) in 1984. These modifications as approved by the Government allowed continuance of the APM recommended by OPC.

1.8 Another Oil Prices Review Committee was constituted by the Ministry of Petroleum and Natural Gas, Govt. of India in September, 1989 to examine the indigenous crude oil prices, prices of petroleum products and allied matters relating to crude oil movement, measurement, quality, etc. After taking into account all the relevant factors including the resource requirements of crude oil producers, reasonable returns to oil companies and the like, the Committee submitted its Report in June, 1991. But the report was not processed further.

1.9 The salient features of the Administered Pricing Mechanism which continued till late 90's were as under:-

1) The pricing of petroleum products for the refining and marketing units was based on the retention concept whereunder oil refineries,

oil marketing companies and the pipelines were compensated operating costs and return @ 12% post tax net worth.

2) The ex-storage ceiling selling prices were uniform at all the refineries.

3) For consumers, the selling price of a product was arrived at by adding the applicable freight from the oil refinery to the Depot and from Depot to the Retail Outlets or direct consumers. Dealers commission wherever applicable was also added.

4) The prices of certain petroleum products like kerosene, LPG (domestic) and feed stocks for fertilizer units were subsidized for socio economic reasons. Similarly, fuels like petrol, ATF, LPG for industrial use were priced above the cost of production to discourage their inessential use.

5) The prices of petroleum products were reviewed and revised from time to time to see that oil pool accounts were balanced.

1.10 The Administered Pricing Mechanism (APM) implemented by OCC ensured stability of prices insulating domestic market from the volatility of prices in international markets. APM also took care of regulated returns to the oil companies at reasonable levels consistent with efficiency of operations to generate sufficient resources for encouraging growth of infrastructure facilities and minimized the cross haulage of products by making the products available at a uniform price at all refineries.

(C) Import Parity Pricing System

1.11 The APM continued through the late 1970s, 1980s and mid 1990s. But the explosive growth in the late 1990s required the Government to call for funds from private and international investors. The ability of the oil companies to generate investible surpluses was reduced considerably by the APM which allowed returns on the depreciated net fixed assets. Accordingly, the Government, in 1995, set up an industry study group under the Chairmanship of Mr. U. Sundararajan, C&MD, BPCL to prepare the blue print of the deregulation and tariff reforms required in the oil sector . The report of this Study Group formed the main input for the strategic Planning Group on Restructuring of the Indian Oil Industry otherwise known as the "R" group headed by the then Secretary, P&NG, Dr. Vijay Kelkar. The "R" Group submitted its report in September, 1996, recommending dismantling of the APM for the following main reasons:-

- Cost Plus compensation did not provide strong incentive for cost reduction thereby breeding inefficiencies.
- Absence of internationally competitive petroleum sector in the context of global economy.
- With the entry of private sector, gold plating of the costs would be encouraged.
- Wide distortion in consumer prices due to subsidies/ cross subsidies.
- Adverse impact on oil companies due to huge deficits in Oil Pool Accounts as price revision was not timely.

1.12 The group's recommendations were approved by the Government in principle in September, 1997 and further action was started. The Government appointed an "Expert Technical Group (ETG)" to study the phasing and tariff structure of the oil sector. The recommendations of this group were notified in November, 1997. The ETG headed by Mr. Nirmal Singh, Joint Secretary Refineries, MOP&NG recommended, inter-alia, the following:-

- There should a phased deregulation of the sector spread over a period of four to five years, culminating in total deregulation by 1.4.2002.
- The first phase should encompass full deregulation of upstream/ refineries and partial deregulation of marketing sectors,
- The customs tariff structure, which provided for a negative duty protection needs to be amended so as to attract investments to the sector,
- Changes in tariff structure may be done over the transition phase, keeping in mind the equilibrium to be maintained between the

Governments' revenue needs, necessity to keep low consumer prices and the need to increase the profitability of the companies.

- Subsidies should be phased out gradually to within acceptable limits which will be provided through the budget.
- In the end, on deregulation, the duties be so positioned that the tariff protection becomes 25% of the value addition while the Government revenue is maintained.

1.13 Accordingly, in the first phase, effective 1.4.1998, the APM was dismantled for the upstream and refining sector and a partial deregulation took place for the marketing sector. Subsequently, effective 1.4.2002, the Government announced complete dismantling of APM.

CHAPTER II

PRICING OF CRUDE

2.1 Till late sixties, bulk of the crude that was needed for our requirements was being imported into the country from West Asia. But after Mumbai High was discovered our dependence in terms of crude imports and crude throughput at the refineries started decreasing. Import dependency decreased from 65.7% in 1973-74 to 18.5% in 1984-85. But, thereafter, it started showing an upward trend touching 36.2% in 1990-91 and to 69.2% in 2000-01. Today about 70% of the crude we need is being imported and the indigenous share amounts to just 30% of our requirements. Based on the relative growth in demand and production, it is estimated that oil dependence will be as high as 85 per cent in 2020.

2.2 Oil and Natural Gas Corporation Limited (ONGC) and Oil India Ltd. (OIL), the two National Oil Companies (NOCs) and private and joint-venture companies are engaged in the Exploration and Production (E&P) of oil and natural gas in the country. Crude oil production during 2003-04 was 33.37 MMT by ONGC, OIL and private/ joint venture companies. Crude oil production target for 2004-05 was 33.64 MMT. However, actual production during 2004-05 was 29.4 MMT (provisional).

(A) Pricing of Indigenous Crude

2.3 Prior to 1981, crude oil prices were fixed on various considerations like import parity, long run marginal cost etc. In 1981, Government revised crude oil pricing departing from OPC concepts. Thereafter, the prices of indigenous crude oil were unchanged till 1992 when the Cabinet Committee on infrastructure reviewed the crude pricing and observed that due to unremunerative price of indigenous crude oil, ONGC and OIL, the two public sector undertakings under the administrative control of the Ministry of Petroleum and Natural Gas engaged in exploration and production of oil and gas, were unable to generate resources for developing more oil fields and exploration in new areas. The Cabinet Committee recommended that the domestic well head price of crude oil should be so determined as to compensate ONGC and OIL for the cost of production and reasonable return on investment. Thus under APM, the prices of indigenous crude oil were based on cost plus return of 15% post tax on capital employed. The basic price of crude oil produced by ONGC and OIL were revised in 1992, 1993 and 1996 as per the data shown below:-

Date of Revision	Crude Oil basic price (Rs./MT)
16.9.92	1506.00
1.4.93	1796.00
1.4.96	2119.73

2.4 Effective 1.4.1998, the crude oil producers had been paid a pre announced increase in percentage (75% for 1998-99, 77.5% for 1999-2000, 80% for 2000-01 and 82.5% for 2001-02) of the international FOB prices on a year-to-year basis subject to a floor of Rs. 1,991/ MT and a ceiling of Rs. 5,570/ MT (Rs. 6,470/MT for March 2002). Post APM, effective 1.4.2002, consequent to dismantling of APM, the prices of indigenous crude oil are determined on the basis of the Crude Oil Sales Agreement (COSA) between the producers and the refineries by benchmarking various indigenous crude oils to equivalent international crude oils.

2.5 The import parity price of ONGC crude oil from 2002-03 onwards is inclusive of the following components

(i) FOB price of respective marker crude adjusted for Gross Product Worth
(ii) Ocean freight
(iii) Ocean Loss
(iv) Insurance
(v) Custom Duty
(vi) NCCD@Rs. 50/T (applicable from 01. March 03)
(vii) Port dues
(viii) Octroi (applicable for Mumbai refineries of HPCL and BPCL only)

2.6 As far as OIL is concerned, since 1.4.2002 , its crude oil has been bench marked to Nigerian Bonny Light due to its similarity in quality. However, OIL does not receive the full import parity price and instead receives only the FOB price adjusted for Gross Product Worth (GPW) and discount towards Base Sediment and Water (BS&W) plus 50% of pipeline transportation charges in respect of crude oil sales to all refineries except NRL (NRL does not pay any pipeline transportation charges), if the FOB price of crude oil is above US$ 21 per bbl. However, if the crude oil price is below US $21 per bbl, OIL would receive sales tax in addition to FOB price plus 50% of pipeline transportation charges, as stated above. However, the FOB price has always remained above US$21 per bbl since 1.4.2002.

2.7 The various components that are considered while determining the pricing of crude oil in terms of the Memorandum of Understanding signed by OIL are as under;-

(i) Monthly average of high – low Free on Board (FOB) price of Nigerian Bonny Light as per PLATTS Oilgram.

(ii) Difference in quality between Bonny Light and OIL's crude oil (termed as Gross Product Worth) determined on the basis of product yield and prices on 4 cut basis. The 4 cuts are:-

- LPG cut (Propane and Butane derived from Saudi Aramco Contract price Ex. Arab Gulf) up to C4.
- Naphtha (C5-175) FOB, Singapore.
- Gas Oil 0.5% "S" (C-175 – 350) FOB, Singapore and
- Fuel oil 180 CST 2% and LSWR (in equal proportion) (C 350+) FOB, Singapore.

(iii) Base, Sediment and Water

(iv) RBI reference rate for conversion to India Rupees.

(B) Pricing of Imported Crude

2.8 Regarding imported crude oil, the pricing is based on the actual cost incurred by various refineries while importing the same and comprises items like FOB cost, freight to India, Insurance, ocean loss, customs duty, wharf age etc.

2.9 In the international oil market, crude oil is traded based on market related pricing. The absolute price of crude oil is not fixed at the time of finalization of the contract and price prevailing at the time of loading of cargo is taken. For example, crude oil of major exporting countries like Saudi Arabia, Iran, Iraq, Kuwait etc. is sold by National Oil Companies on term basis for one year. However, the price for cargoes loaded in different months is different and dependent on the price prevailing in the month of loading.

2.10 Further, since there are more than 100 grades of crude oils produced in the world and all are not actively traded, the methodology of pricing of crude oil is based on one “Reference” or “Marker” crude oil that is actively traded in a particular region. Typically there is a premium or discount over the “Marker” due to quality/ locational differences etc.

Indian Basket of Crude Oils

2.11 For high sulphur crude oils imported by India, Oman and Dubai are the Marker crude oils. For most low sulphur crude oils imported by India, Brent is the marker crude oil. Considering the proportion of import of low sulphur and high sulphur crude oil into the country, an indicative Indian Basket price has been devised with weightage of 57% to the average of Oman and Dubai and weightage of 43% to Brent price. Based on the above weightage, price can be worked out on daily, weekly, monthly and yearly basis. It may be pertinent to note that Indian Basket price is not the price of actual imports but only an indicator for reference purpose.

2.12 When the Committee desired to know the quarterly average price of Indian basket during each of last 3 years, the Ministry of Petroleum and Natural Gas furnished the following information :-

(In $ bbl)

Quarter	Oman/Dubai Average	Brent	Indian Basket
Jan-Mar 02	20.12	21.09	20.54
Apr-Jun 02	24.45	25.07	24.72
Jul-Sept 02	25.56	26.91	26.14
Oct-Dec 02	25.27	26.81	25.93
Jan-Mar 03	28.59	31.49	28.84
Apr-Jun 03	24.60	26.03	25.22
July-Sept 03	26.74	28.38	27.44
Oct-Dec 03	27.88	29.43	28.55
Jan-Mar 04	29.69	32.03	30.70
Apr-Jun 04	33.37	35.32	34.21
Jul-Sept 04	36.49	41.54	38.66
Oct-Dec 04	36.43	43.85	39.62

Crude contracts:

2.13 Crude imports are generally done through commercial agreements/ contracts entered into by various Indian Companies with National Oil Companies of oil producing countries named as term contracts. Crude is also procured from open market on spot basis through tenders. The salient features of crude oil term contracts are stated to be as under:

1. Seller company
2. Buyer company
3. Volume of crude oil to be imported during the contract period and is to be lifted as far as possible on uniform basis round the year.
4. Contract period: Typically on annual basis from April- March
5. Grades of crude oil- The grades of crude oil like Arab Light/ Arab Heavy (Saudi Arabia); Iran Light/ Iran Heavy (Iran), Basrah Light (Iraq) etc. are specified.
6. Pricing basis: Official selling prices which are uniformly applicable to all term lifters in the region
7. Payment: Typically payment is made by oil PSUs 30 days after the cargo is loaded.
8. Destination restriction: This clause specifies that the crude oil is for consumption within India.
9. Governing law: Typically sellers include their local law.

2.14 Besides the above, there are several general terms and conditions covering shipping aspects like laytime/ demurrage/ inspection etc; assignment, liquidation, notices, force major condition etc.

2.15 Crude procurement through spot tenders are also done on almost the same lines as that of term contracts except that the contract period is generally one month and the pricing basis is as finalized in the tender.

2.16 The estimated percentage of crude import through term contracts as against total crude import of the major crude importing Oil PSUs for the year 2004-05 are as given below:

	%age
IOC and subsidiaries	62
HPCL	62
BPCL	66
KRL	75
MRPL	98

2.17 The actual import of crude in terms of quantity and value since 2002-03 as furnished by the Ministry are as follows:-

Crude Imports

	2002-03		2003-04 Provisional		2004-05 Provisional	
	Qty.	Value	Qty.	Value	Qty.	Value
Public Sector	46,593	44,491	60,294	56,790	64,508	81,893
Joint Sector	7,210	6,756				
Private Sector	28,186	24,948	30,140	26,738	31,353	35,139
Total Crude Imports	81,989	76,195	90,434	83,528	95,861	117,032

(C) Cost of production of ONGC and OIL

2.18 The average cost of production of crude oil produced by ONGC during 2002-03, 2003-04 and 2004-05 inclusive of operating cost, recouped cost, statutory levies (royalty, cess, NCCD, sales tax, octroi and BPT charges) and 15% post tax return on capital employed is as follows:-

Year	Rs. /BBL	US$/BBL
2002-03	1070.43	22.12
2003-04	1132.66	24.65
2004-05 (Provisional)	1234.00	27.46

2.19 The average cost of production of crude oil by OIL during the same period comprising of operating cost, recouped cost, normative return, statutory levies (royalty, cess and sales tax) and transportation charges as being absorbed by OIL is as given under:-

Year	Rs./ BBL	US$/BBL
2002-03	936.73	19.35
2003-04	922.56	20.10
2004-05	1055.32	23.49

2.20 Against this cost of production, the average price realization (net of subsidy sharing) in respect of ONGC during four quarters of financial year 2002-03, 2003-04 and 2004-05 is summarized below:-

US$/ Barrel

	2002-03	2003-04	2004-05
First Quarter	25.67	24.44	33.98
Second quarter	28.07	26.78	38.75
Third quarter	28.02	27.34	39.87
Fourth quarter	32.31	29.62	44.99
Yearly Average	28.50	27.11	39.38

2.21 The average price realization of crude oil produced by OIL (net of subsidy sharing) during 2002-03, 2003-04 and 2004-05 is given below:

Year	Rs./MT	Rs./BBL	US$/BBL
2002-03	9323.48	1294.93	26.75
2003-04	9424.35	1308.94	28.82
2004-05	11391.99	1583.98	35.25

(D) Taxes and Duties on Crude

2.22 In the cost of production of indigenous crude oil, Cess and Royalty form major components. Cess is levied by Central Government whereas Royalty is collected by respective State Governments.

<u>Cess</u>

2.23 Cess is levied and collected under Section 15 of the Oil Industry (Development) Act. 1974, which was enacted following successive and steep increase in the international prices of crude oil and petroleum products since early 1973, when the need of progressive self reliance in petroleum and petroleum based industrial raw materials assumed great importance. Accordingly, the Oil Industry Development Board (OIDB) was set up in Jaunary, 1975 under the Act, to provide financial assistance for the development of Oil Industry.

2.24 The functions of the Board, as defined in Section 6 of the Act, involve rendering financial assistance to the promotion of all such activities that are, in its opinion, conducive to the development of the Oil Industry. The financial assistance is extended by way of loans and grants for activities such as prospecting, refining, processing, transportation, storage, handling and marketing of mineral oil, production and marketing of oil products and production of fertilizers and chemicals.

2.25 The funds required for various activities, envisaged under the Act, are made available by the Central Government after due appropriation by Parliament from the proceeds of cess levied and collected on indigenous crude oil excepting on blocks in joint ventures under New Exploration Licensing Policy (NELP) and on Natural Gas. The proceeds of this duty are first credited to the Consolidated Fund of India and sums of monies, as the Central Government think fit, are made available to the OIDB after appropriation by the Parliament.

2.26 While replying to a query regarding the quantum of cess collected so far under OIDA and the money released to OIDB, the Ministry stated in a note:-

> "Since inception and upto 31.3.2005, the Central Government has collected a sum of about Rs. 55966.81 crore cess. Out of this, the OIDB has received an amount of Rs. 902.40 crore till March, 2005.
>
> The rate of cess currently is Rs. 1800/- per tonne on crude oil produced in the country as compared to Rs.900 per tonne till 28.2.2002. Cess has been abolished under the New Exploration Licensing Policy (NELP) in order to encourage Exploration and Production activities in India. All investors venturing in E&P activities in India under NELP including National Oil Companies both Public and Private and Multinational companies are provided level playing field and no cess is payable on production from areas licensed / leased under NELP. Under PSC regime applicable discovered fields, cess has been frozen at Rs. 900 per MT. No cess has been levied on Natural Gas Production in the country.
>
> As on 31.3.2004, the OIDB has given Rs. 16,861 crore financial assistance to the oil industry of which Rs. 16,182 crore was loan and Rs. 679 crore was in the form of grant given to oil companies since 1975."

2.27 Regarding levy and utilization of cess, the Committee have been informed by the Ministry of Petroleum and Natural Gas that the Ministry of Finance is of the view that the cess is meant for funding the "oil industry" under the Oil Industry Development Act, 1974 and Section 2(K) of the Act defines this term to include all activities by way of prospecting or exploring for or production of mineral oil, refining, processing, transportation, storage, handling and marketing of mineral oil, production and marketing of all products downstream of an oil refinery and the production of fertilizers and petro-chemicals and all activities directly or indirectly connected therewith. Thus, the term "oil industry" includes fertilisers and petro-chemicals also for the purpose of the Act. The expenditure on the "oil industry" is in excess of the cess collection.

Royalty

2.28 State Governments receive royalties on crude extracted from their respective jurisdictions. Royalty in respect of mineral oil is payable under the provisions of Section 6(A) of the Oilfields (Regulation and Development) Act, 1948 and the Petroleum and Natural Gas Rules, 1959. According to these provisions, rate of royalty shall not exceeds 20% of the sale price at the oilfields or the oil well head. The rate of royalty shall not be enhanced more than once during any period of three years. Government had revised the rate of royalty for crude oil for the period 1.1.1990 to 31.3.1993 to Rs. 481/MT. Thereafter till 1996, payment at the enhanced rate of Rs. 539.20/ MT towards royalty on crude oil was being made which got further revised to Rs. 595/MT w.e.f 1.4.1996.

2.29 From 1.4.98 to 31.3.2002 royalty was being charged at the rate of 20% of well head price. Effective 1.4.2002 royalty for onshore was @ 20% of well head price and shallow water offshore (upto 400 metes) and @ 10% of well head price, for off shore above 400 meters. Moreover, royalty during the first seven years of production for offshore is half of the rates applicable for shallow water. For heavier crude of API 25 deg. and less, royalty rate will be 2.5% less than applicable rates for normal crude oil from onland and offshore.

Customs Duty

2.30 Customs duty, a central duty, consists of basic customs duty and additional duty of customs, also known as countervailing duty or CVD, which is equivalent to the excise duty on the same product produced domestically. Crude, which is the input to refineries, does not attract any excise.

2.31 Customs duty on crude, after being `specific’, that is a specific sum of rupees per tonne, until end-March, 1994, was 35 per cent ad valorem for the two subsequent years. It was gradually reduced over time to 10 per cent in 2001-02 and kept unchanged thereafter till 2004-05. But, effective 1.3.2005, this has further been brought down to 5 per cent. In 2003-04, of the total customs duty realization of Rs. 9552 crore under POL, 70.8% came from crude with the balance coming from refined products.

Other taxes and levies

2.32 Entry tax/ octroi is levied on the movement of crude in some states. This entry tax faced by refineries in 2003-04 was between 2 and 4 per cent.

Entry tax/ octroi faced by refineries

Refinery	Rate (in per cent)
Bharat Petroleum/ Hindustan Petroleum, Mumbai, Maharashtra	3
Indian Oil, Mathura, Uttar Pradesh	4
Mangalore Refineries, Karnataka	2
Indian Oil, Barauni, Bihar	2
Indian Oil, Panipat, Haryana	4

CHAPTER III

PRICING OF PETROLEUM PRODUCTS

3.1 Crude oil, both indigenous and imported, are refined into various petroleum products viz. motor spirit, naphtha, light diesel (light distillates), aviation fuel, kerosene, high speed diesel (middle distillates) furnace oil, bitumen, waxes, etc. (heavy distillates). The demand for petroleum products is rising rapidly in the country. During the 9th Plan (1997-2002), consumption of petroleum products grew by 4.9 per cent. The consumption of products is estimated to reach 120.4 MMT by the terminal year of the 10th Plan, i.e. 2006-07, resulting in a compound annual growth of 3.7 per cent for the Plan period.

3.2 The pricing of these refined products have gone through various phases. Moving from Valued Stock Account system to import parity pricing and then to retention pricing, the industry has now entered another era of complete deregulation with a shift to market determined pricing mechanism.

3.3 Though the process of deregulation of the prices of petroleum products started in 1998, five commodities viz. petrol, diesel, domestic LPG, PDS kerosene and aviation fuel continued to be controlled commodities. ATF was later decontrolled w.e.f. 1.4.2001. But until 31st March, 2002, there was Administered Pricing Mechanism for the other four commodities. Ever since APM was completely dismantled, oil companies were allowed the leeway to sell their products at market determined prices guided by the concept of import parity. Consequently, retail prices in the domestic market tend to fluctuate in tandem with global price movements. This means, in the post-APM era starting from 1.4.2002, Oil Marketing Companies (OMCs) have been given the right to determine the selling prices of petrol and diesel (except PDS kerosene and domestic LPG which are subsidized) based on Import Parity Mechanism, after prior consultations with MOP&NG.

(A) Import Parity Pricing Mechanism of Petroleum Products

3.4 Import parity price means the price that the actual importer would pay for the imported product. The various components of import parity price of petroleum products are given below.

a Free on Board Price (FOB) as quoted in Arab Gulf Market and reported by Platt and Argus,

b Premium/ discount as published in Platt and Argus,

c Ocean freight from mid port in the Arab Gulf to Indian Ports,

d Insurance,

e Exchange rate,

f Custom Duty ,

g Ocean Loss,

h Wharfage and Port charges.

3.5 The retail selling prices of petroleum products are built upon this notional price at which these products would have been imported into the country and not on the basis of the actual ex-refinery price of these products. The retail selling price of petrol/ diesel for the consumers is thus calculated by adding freight up to depots, marketing cost and margin, state specific irrecoverable levies, excise duty, delivery charges from depot to retail pump outlet, sales tax and other local levies and dealers commission to this basic price at refinery level on import parity basis.

3.6 The basic ex-storage selling prices of petrol and diesel are uniform at all refinery locations throughout the country and as per the existing arrangement between the oil marketing companies and refineries, this basic price at refinery level on import parity basis is revised on fortnightly basis depending upon the prevalent international prices.

3.7 The marketing costs and margins, dealers' commission, delivery charges within free delivery zones are also uniform. The prices at various locations will vary depending upon the distance from the refinery, rate of sales tax and other local levies.

3.8 In case of Kerosene (PDS) and LPG (Domestic) the Government has decided that the subsidies on these products will be on a specified flat rate basis for each Depot/ Bottling Plant and will be met from the fiscal budget. After providing for the aforesaid subsidy, the retail prices would then vary as per changes in the international oil prices

Decontrolled Scenario-petrol, Diesel, SKO & LPG

3.9 Initially from 1.4.2002 till about end of December, 2003, the Companies used to set the prices of petrol and diesel every fortnight and they were doing so because the crude market and the petroleum market were relatively stable. But during this period, any hike in retail selling price of PDS Kerosene and domestic LPG had been spared by oil marketing companies.

3.10 In 2004, the oil prices started rising in the international market. Although the oil marketing companies were granted freedom to fix retail selling prices on fortnightly basis, the prices were being revised after informal clearance from MOP&NG and there was no price revision of petrol and diesel from the period 1.1.2004 to 15.6.2004 although the ruling prices in the international market were abnormally high during this period. Same was the case with SKO and LPG. But w.e.f. 16.6.2004 finally moderate increases to the extent of Rs. 2 per litre on petrol and Re 1 per litre on diesel were made coupled with excise duty changes .Retail selling price of LPG (packed domestic) too was raised by Rs. 20 but kerosene was again spared of any hike.

3.11 Government worked out a new methodology with effect from 1st August, 2004 allowing OMCs limited freedom to revise the price of MS/ HSD within a price band. The concept of price band was based on the principles of rolling average prices of these products in the international markets. Accordingly, oil companies were permitted to carry out autonomous adjustments in prices within a band of +/- 10% of the mean of rolling average C&F prices of last 12 months and last quarter, i.e. three months.

3.12 In case of breach of this band, the OMCs have to approach the Ministry of Finance through MOP&NG to modulate the excise duty rates so that the spiraling prices prevailing in the international markets do not cause undue hardships to the consumers.

3.13 The year 2004-05 witnessed unprecedented high oil prices in the international market. As compared to the average Indian basket crude price of US$ 27.98/ barrel during 2003-04, the average price during 2004-05 (April, 2004-January, 2005) was US $37.87 /barrel. During February and first fortnight of March, 2005, these prices were stated to be US $ 42.67/ barrel and US $ 48.98/ barrel respectively. To contain the impact of increase in international prices of petroleum products on domestic prices, the Government reduced excise duty on petrol from 30% to 26% and on diesel from 14% to 11% effective 16.6.2004. The duty was further reduced on petrol from 26% to 23% and on diesel from 11% to 8% with effect from 19.8.2004. The Government has also reduced customs duty on petrol and diesel from 20% to 15% with effect from 19.8.2004. On 16.06.2004, excise duty on LPG (Domestic) was reduced from 16 per cent to 8 per cent. On 19.08.2004, excise duty on PDS Kerosene was reduced from 16 per cent to 12 per cent.

3.14 However, the international prices went up further during the month of October, 2004. With the under-recoveries on petrol and diesel estimated to be around Rs. 3000 crores for the period April-October, 2004, further increases were announced effective 5.11.2004. Retail selling price of petrol was fixed in line with the import parity price. The retail price of petrol was further revised downwards in line with international prices effective 16.11.04. However, the increase in the diesel retail price was pegged at 50% of the level of increase required on the basis of import parity and no further increase was made in the diesel price on 16.11.2004.

3.15 The retail selling price of LPG (Packed Domestic) was revised by the oil marketing companies effective 16th June, 2004 and again on 5th November, 2004 by Rs. 20 per cylinder each time, in view of the abnormally high prices of crude oil and petroleum products in the international market. But the oil marketing companies did not hike the retail selling price of PDS kerosene oil marketing companies since April, 2002.

3.16 In the Budget 2005-06, the following changes have, inter-alia, been announced effective 1.3.2005 :-

Item	Pre-revised (as on 28.2.2005)	Revised (as on 1.3.2005)
Customs tariff		
Crude Oil	10%	5%
Petrol	15%	10%
Diesel	15%	10%
Kerosene	5%	NIL
LPG	5%	NIL
Others	20%	10%
Excise Tariffs		
Petrol	23%+Rs.7.50/Ltr.	8%+Rs.13/Ltr.
Diesel	8%+Rs.1.50 /Ltr.	8%+Rs.3.25/Ltr.
PDS Kerosene	12%	NIL
Domestic LPG	8%	NIL

Education cess @ 2 per cent leviable on the above taxes w.e.f. 09.07.2004

3.17 With the customs and excise tariffs revised in the above lines, the road cess increased by Rs. 0.50 from Rs. 1.50, and the international prices of crude and petroleum products reaching an all time high, the prices of petroleum products were revised on 21.6.2005 by the Government, with a hike of Rs. 2.50/ Litre for petrol and Rs. 2.00/ Litre for diesel in Delhi. However, the prices of Kerosene and LPG were not hiked.

3.18 During the course of the evidence, the Committee wanted to know the share of the international prices and restructured duties in the enhanced domestic prices. The Secretary, P&NG deposed as follows before the Committee:-

"……..Rs. 0.50 per litre was the additional excise duty in the nature of cess or cess in the nature of additional duty that was raised. It was for the Department of National Highways for construction of roads. That is the additional duty part and the rest is restructuring part. The total impact on petrol and diesel of these restructuring and additional duty has been on petrol Rs. 2.20 per litre and on diesel, Rs. 1.06 per litre. Added to this, the impact of improved fuel quality which the companies are obliged to provide comes to Rs. 0.30 per litre for petrol and Rs. 0.24 per litre for diesel. These two components taken together in the case of petrol, it comes to Rs. 2.50 which does not include any price rise and in the case of diesel, it comes to Rs. 1.30 which does not include any price rise. So, in diesel, it is Rs. 0.70 that the Government has allowed which is the component which is relating to price rise. In petrol, the entire cost of Rs. 2.50 is for restructuring of additional duty and the improved quality. This is the position"

(B) Taxes and Duties on Petroleum Products

3.19 Taxation on petroleum products is an important source of revenue for the Central Government and State Governments. Petroleum products are taxed both at the level of the center as well as at the level of State and local bodies. Central duties consist of customs and excise. Customs duty, in turn, consists of basic customs duty and additional duty of customs, also known as countervailing duty (CVD), which is equivalent to the excise duty on the same product produced domestically. Excise duty is levied on all petroleum products by the Centre whereas State Governments levy sales tax on them.

3.20 Basic customs duty was nil on all petroleum products except naphtha, lubricating oil and LPG until end-March, 1994. The 1994-95 Budget introduced basic customs duty on all products except kerosene, while reducing the duties on lubricating oil and LPG. By 2001-02, customs duty on petrol and diesel was 20% which got reduced to 15% w.e.f. 18.8.2004 and to 10% from 1.3.2005.

3.21 Excise duty on petroleum products was specific until end-March, 1994. The duties were converted to ad valorem at the rate of 20% for petrol and 10% for all other products in the Budget for 1994-95. Over the years, the rates have undergone a gradual upward shift. While the basic excise duty has remained unchanged at 16% since 1999-2000, additional excise duty on petrol was introduced in June, 1998 and extended to diesel in 1999 to fund road construction. A special excise duty was also imposed on petrol in 1999. A special additional excise duty on petrol has also been in force since April, 2002 as surcharge for National Highway project. Through the budget 2005-06, the excise duty on petrol has been revised to a specific, ad valorem mix of 8% + Rs. 13/ litre and that on diesel to 8% + Rs. 3.25/ litre.

3.22 With effect from 9.7.2004 an additional levy of Education Cess @2% has been imposed on the aggregate of all excise and customs duties. An additional excise duty of Paise 50/litre too has been imposed as road cess during 2005-06. The details of additional duty of excise (cess) on petrol and diesel collected during the years 2000-01 to 2003-04 are given as under:-

(Rs./crores)

Year	Amount
2000-01	5099.00
2001-02	5326.21
2002-03	5241.25
2003-04	7439.57

<u>Tax Component in the pricing of products</u>

3.23 The tax component or non-fuel component which comprises customs duty, excise duty, sales tax and additional excise duty /cess forms quite a high proportion in the retail pricing of petroleum products.

3.24 During evidence, while replying to a query regarding components of taxes in the total retail prices of Petrol and Diesel, Secretary, P&NG stated as under:-

"Coming to the taxes, we have a build up of prices in which more than fifty per cent of the price is taxes. Taxes are about 132 per cent of the basic price. Out of the total price, 57 per cent is taxes for petrol; for diesel it is 35 per cent. So, if Rs. 40 is the petrol price, then 57 per cent, that means nearly Rs. 22 will be tax and Rs. 18 will be petrol price; if the price of diesel is Rs. 30, then one-third, that means Rs. 10 is tax and Rs. 20 is the price of diesel."

3.25 The percentage tax on petrol in Mumbai,Chennai, Kolkata and Delhi is 146%,138%,132% and 112% respectively. The share of taxes in retail selling prices of Petrol and Diesel in Delhi, Chennai, Kolkata and Mumbai during 2004-05 before the revision in prices based on the tariff changed effected through the Budget 2005-06, is as under:-

Share of duties and taxes in Retail Selling Price of Petrol Rs/litre

S.No.	Particulars	Delhi	Chennai	Kolkata	Mumbai
1	Price without Customs Duty, Excise duty and sales tax components	17.87	17.28	17.60	17.54
2	Custom Duty @ 15% included in (RTP) Import parity, weighted average, base grade – Jan-II FN	1.71 5% *	1.71 4%	1.71 4%	1.71 4%
3	Excise duty (levied @ 23% + Rs. 7.50 /litre plus 2 per cent education cess)	12.07 32%	12.11 29%	12.14 30%	12.26 28%
4	Sales Tax (incl. Irrecoverable taxes)	6.19 16%	10.15 25%	9.44 23%	11.72 27%
5	Total of Customs Duty, Excise Duty and Sales tax components (2+3+4)	19.97 53%	23.97 58%	23.29 57%	25.69 59%
6	Retail selling price at Delhi (1+5)	37.84	41.25	40.89	43.23

* % Figures below give the components of customs duty, excise duty and sales tax as a % of S.No.6.

Share of duties and taxes in retail selling price of Diesel Rs/Litre

S.No.	Particulars	Delhi	Chennai	Kolkata	Mumbai
1	Price without Customs Duty, Excise duty and sales tax components	18.39	18.29	18.31	18.28
2	Custom Duty @ 15% included in (RTP Import parity, weighted average, base grade – Jan-II FN	1.97 7% *	1.97 7%	1.97 7%	1.97 6%
3	Excise duty (levied @ 8% + Rs. 1.50/ litre plus 2% education cess)	3.15 12%	3.15 11%	3.17% 11%	3.18 10%
4	Sales Tax (incl. Irrecoverable taxes)	2.77 11%	5.89 20%	5.27 18%	9.40 29%
5	Total of Customs Duty, Excise Duty and Sales tax components (2+3+4)	7.89 30%	11.01 38%	10.41 36%	14.55 44%
6	Retail selling price at Delhi (1+5)	26.28	29.30	28.72	32.83

**Figures below give the components of customs duty, excise duty and sales tax as a % of S.No.6.*

Share of duties and taxes in the prices of these products in Delhi after the revision of retail prices made on 21.06.05 is as under:-

	PETROL	
S.No.	Particulars	DELHI/ (Rs/Litre)
1.	Price without Customs Duty, Excise duty and sales tax components	17.35
2.	Custom Duty (@ 10% included in RTP) Based on RTPs applicable for II fortnight of July 05).	1.65 4%*
3.	Excise Duty (levied @ 8% + Rs. 13/ Ltr. Plus 2% education cess)	14.74 36%
4.	Sales Tax (incl. Irrecoverable taxes)	6.75 17%
5.	Total of Customs Duty, Excise Duty and Sales Tax components (2+3+4)	23.14 57%
6.	Retail Selling Price (1+5)	40.49
	*Figures below give the components of customs duty, excise duty and sales tax as a % of S.No.6.	
	DIESEL	
S.No.	Particulars	DELHI/(Rs./Litre)
1.	Price without Customs Duty, Excise duty and sales tax components	18.37
2.	Custom Duty (@10% included in RTP) Based on RTPs applicable for II fortnight of July 05.	1.99 7%
3.	Excise Duty (Levied @ 8% + Rs. 3.25/litre plus 2% education cess)	4.93 17%
4.	Sales Tax (incl. Irrecoverable taxes)	3.16 11%
5.	Total of Custom Duty, Excise Duty and Sales Tax components (2+3+4)	10.08 35%
6.	Retail Selling Price (1+5)	28.45
Figures below give the components of customs duty, excise duty and sales tax as a % of S.No.6		

3.26 The share of duties and taxes in the retail selling prices of LPG and kerosene during 2004-05before effecting the changes in the Budget (2005-06) are as follows:-

Share of duties and taxes in retail selling price of LPG (Packed Domestic)

S.No.	Particulars	Delhi	Chennai	Kolkata	Mumbai
1	Price without Customs Duty, Excise duty and sales tax components	229.51	228.13	230.41	228.10
2	Custom Duty @ 5% included in (RTP Simple average for all ports, – Jan'05 RTP	14.69 5%	14.69 5%	14.69 5%	14.69 5%
3	Excise duty (Presently levied @ 8%)	17.75 6%	18.21 6%	18.13 6%	17.97 6%
4	Sales Tax (incl. Irrecoverable taxes)	19.65 7%	27.12 9%	46.42 15%	31.09 11%
5	Total of Customs Duty, Excise Duty and Sales tax components (2+3+4)	52.09 18%	60.02 21%	79.24 26%	63.75 22%
6	Retail selling price at Delhi (1+5)	281.60	288.15	309.65	291.85

*Figures below give the components of customs duty, excise duty and sales tax as a% of S.No. 6.

Share of duties and taxes in retail selling price of PDS Kerosene.

S.No.	Particulars	Delhi	Chennai	Kolkata	Mumbai
1	Price without Customs Duty, Excise duty and sales tax components	7.13	6.41	7.31	7.12
2	Custom Duty (@ 5% included in RTP) Simple average for all ports Jan'05 RTP	0.70 8%	0.70 8%	0.70 8%	0.70 8%
3	Excise duty (Presently levied @ 12%)	0.86 10%	0.87 10%	0.86 9%	0.86 9%
4	Sales Tax (incl. Irrecoverable taxes)	0.32 4%	0.42 5%	0.43 5%	0.58 6%
5	Total of Customs Duty, Excise Duty and Sales tax components (2+3+4)	1.88 21%	1.99 24%	1.99 21%	2.14 23%
6	Retail selling price at Delhi (1+5)	9.01	8.40	9.30	9.26

** Figures below give the components of customs duty, excise duty and sales tax as a % of S.No. 6.*

3.27 The retail price of petroleum products vary widely from state to state as the final prices of these products include an element of state sales tax also. In some states sales tax is very high. For example, sales tax on diesel is close to 37.97% in Mumbai, whereas it is only 12.5% in Delhi.

3.28 The current effective (as on 01.07.2005) rates of recoverable sales tax on petrol, diesel, PDS kerosene and domestic LPG in various states/ UT's are:

Effective rates of sales tax/VAT as on 01.07.2005, (Percentage (%))				
	Petrol	Diesel	PDS Kerosene	Domestic
Andhra Pradesh	34	23	4	12.5
Arunachal Pradesh	20	12.5	4	12.5
Assam	27.5	16.5	4	9
Bihar	27	22	12.5	12.5
Chhatisgarh	25	25	2.3	9.2
Chandigarh	22	12.1	8.8	8.8
Delhi	20	12.5	4	12.5
Goa	24,89	22.86	4	12.5
Gujarat	25.36	22.76	0	14
Haryana	20.46	12.22	4	12.5
Himachal Pradesh	25	14	0	12.5
Jammu and Kashmir	20	12	4	12.5
	+Re1/Ltr as cess			
Jharkhand	20	15	6	9
Karnataka	29.4	21	4	12.5
Kerala	28	24	4	12.5
Maharashtra				
1-Mumbai, Thane and Navi Mumbai	30	34	4	12.5
	Re1/Ltr as Surcharge + Re 1/Ltr as Surcharge			

2- others	29	31	4	12.5
	+Re1/Ltr. As Surcharge + Re1/ Ltr as Surcharge			
Madhya Pradesh	28.75	28.75	0	13.8
Manipur	20	12.5	0	12.5
Meghalaya	20.4	12.75	4	12.5
Mizoram	20	12	0	8
Nagaland	21	12.6	5.25	12.6
Orissa	20	20	4	12.5
Punjab	27.5	8.8	4	12.5
	+Re1/Ltr as Cess			
Rajasthan	28	20	9	14
	+Re0.50/Ltr. As Cess	+Re 0.50/Ltr as Cess		
Sikkim	17.55	9.31	12	12.5
	+Re 1/Ltr. As cess	+Re 1/Ltr. as Cess		
Tamil Nadu	30	25	4	8
Tripura	20	12.5	4	12.5
Uttaranchal	25	21	10	10
Uttar Pradesh	26	22	10.1	10.1
West Bengal	25	17	4	12.5
	+Re1/Ltr. As Surcharge + Re.1 Ltr. As Surcharge			

Note: Excludes Entry Tax wherever, applicable.
Includes impact of VAT in Dealers Commission wherever applicable.

3.29 When asked about the efforts of the Ministry to pursue the State Governments to put a cap on the sales tax levied by them on petroleum products, the Additional Secretary, Ministry of Petroleum and Natural Gas deposed before the Committee as under:-

> "…….we have repeatedly taken it up with the State Government for reduction of sales tax so that State Governments also take some burden of equitable sharing, thereby passing on the resultant benefit to the customer. We have not found the State Governments very responsive till now and we are still making efforts…."

3.30 The Committee further desired to know the total revenue earning of the States and the Centre from POL since 2001-02. The Ministry of Petroleum and Natural Gas provided the following figures:-

(Rs./ crores)

	2002-03	2003-04	2004-05
Contribution to Central Exchequer	64595	69195	77692
Contribution to State Exchequer	32156	35180	43254
Total *	96751	104375	120946

3.31 The contribution towards customs duty, excise duty and cess on petroleum sector vis-à-vis total receipts of Government of India for the years 2002-03, 2003-04 and 2004-05 is tabulated below:-

(Rs./ crores)

2002-03	Contribution of petroleum sector as per data submitted by following oil companies*	Total as per receipts budget of 2003-04 of Government of India- R.E. 2002-03	Percentage contribution of petroleum sector
Customs duty	7953	45500	17%
Excise duty (including Cess on indigenous crude oil)	38177	87383	44%

(Rs./ crores)

2003-04	Contribution of petroleum sector as per data submitted by following oil companies*	Total as per receipts budget of 2004-05 of Government of India- R.E. 2003-04	Percentage contribution of petroleum sector
Customs duty	9552	49350	19%
Excise duty (including Cess on indigenous crude oil)	40130	92379	43%

(Rs./ crores)

2004-05	Contribution of petroleum sector as per data submitted by following oil companies	Total as per receipts budget of 2005-06 of Government of India- R.E. 2004-05	Percentage contribution of petroleum sector
Customs duty	11697	56250	21%
Excise duty (including Cess on indigenous crude oil)	43041	100720	43%

**The above information has been furnished based on data collected from the following oil companies:*

IOCL, ONGC, HPCL, BPCL, NRL, CPCL, OIL, BRPL, IBP, MRPL, GAIL, KRL, EIL and RIL (Refinery Division).

(C) Subsidy on PDS kerosene and Domestic LPG

3.32 As per the decision taken at the time of announcement of APM dismantling, post APM, the Government subsidies on PDS kerosene and Domestic LPG were to be on flat rate basis and after providing for this subsidy, the retail prices were to vary as per changes in the international prices.

3.33 The flat rate of Government subsidy for the year 2002-2003 (first year post APM) was computed as the difference between the cost price and selling price as on 1.4.2002. The average subsidy for 2002-03 worked out as Rs. 67.75/ cylinder on domestic LPG and Rs. 2.45/ litre on PDS kerosene. The Government subsidy was released to the public sector oil marketing companies on a monthly basis after verifying their claims. These subsidies were to be phased out in five years, effective 1.4.2002.

3.34 In addition to the normal subsidy scheme for PDS kerosene and Domestic LPG, there is also a freight subsidy scheme for these products with a view to mitigating the impact of high transportation cost in the selling prices of these products in the far –flung areas. Under Administered Pricing Mechanism this subsidy was met from Oil Pool Account and during post APM period, the subsidy is given from the fiscal budget. Accordingly the subsidy on PDS kerosene and domestic LPG met from Oil Pool Account for the year 2001-02 was as under:-

Subsidy	2001-02
Domestic LPG	
Rs./crores	5830
Rs./Cylinder	115.63
PDS kerosene	
Rs./ crores	5310
Rs./ Litre	4.05
Total	11140

3.35 After dismantling of APM in addition to Government subsidy , public sector oil marketing companies (OMCs) are stated to have been sharing the burden by not passing the full increase in the international prices in the domestic consumer prices of these products. This, they do, by selling at prices that fall short of import-parity prices adjusted for distribution and marketing margin. This leads to under-recoveries, a term reminiscent of the Oil Pool days.

3.36 The details of the total under recoveries sustained by the oil marketing companies on supplies of PDS kerosene and domestic LPG during 2004-05 as furnished by the Ministry are given below:-

Rs/Crores

Product	2004-05 (Provisional)
PDS Kerosene Domestic LPG	9479.88 8362.06
Total	17841.94

3.37 The actual payments released from the Union Budget under PDS kerosene and domestic LPG Subsidy Scheme 2002 has been as under:

Year	Amount (Rs./crore)
2002-03	4495.80
2003-04	6292.44
2004-05	2930.32

3.38 The under-recovery is being shared among the oil marketing companies, the upstream majors and GAIL as per the formula worked out by the Government.

3.39 During the course of evidence, Secretary, P&NG elaborated as under:-

> "…..it is felt that the under-recoveries should be apportioned between the oil companies as well as the upstream companies, particularly ONGC and OIL, which have gained larger revenues and larger income because of high oil prices. It is because they are also getting the price of crude, which is in relation to the international prices. They are not getting exactly equal to the international prices, but it is close to the international prices. The Government has organized the apportionment of under-recoveries. It is done in such a way that 1/3rd of the under-recoveries is given by the upstream companies like ONGC and OIL and to some extent by GAIL, as special discounts to the PSUs which are in the business of refining and marketing of products. Only 2/3rd of the under-recoveries are borne by them."

(D) Refining

3.40 Refining capacity, refining cost and refining margin are other major aspects that need to be looked into while examining the pricing of petroleum products. Since refining sector was delicensed in June, 1998, the refining capacity of the country expanded substantially. At present, the country is surplus in refining capacity as compared to the consumption.

3.41 As on today, there are 18 refineries operating in the country (17 in Public Sector and 1 in Private sector). Mangalore Refinery and Petrochemicals Limited (MRPL) which was a Joint Sector Company became a PSU subsequent to acquisition of its majority shares by ONGC. Out of the 17 Public sector refineries, 7 are owned by Indian Oil Corporation Limited, two each by Chennai Petroleum Corporation Limited (a subsidiary of IOCL), Hindustan Petroleum Corporation Limited and Oil and Natural Gas Corporation Limited (ONGC), one each by Bharat Petroleum Corporation Limited, Kochi Refineries Limited (a subsidiary of BPCL), Numaligarh Refinery Limited (a subsidiary of Bharat Petroleum Corporation) and Bongaigaon Refineries and Petrochemicals (a subsidiary of IOC). The private sector refinery belongs to Reliance Industries Limited.

3.42 Total refining capacity in the country as on 1.10.2004 was 127.37 MMT per annum. Out of this, private refining capacity is 33 MMT per annum, which works out to be 25.9% of the total refining capacity. Details of individual refineries are given below:-

REFINERY	CAPACITY IN TMTPA
	1.4.2004
IOC GROUP REFINERIES	
IOC-GUWAHATI	1000
IOC-BARAUNI	6000
IOC-KOYALI	13700
IOC- HALDIA	6000
IOC-MATHURA	8000
IOC-DIGBOI	650

IOC-PANIPAT	6000
BRPL- BOGAIGAON	2350
CPCL-CHENNAI	9500
CPCL- NARIMANAM	1000
IOC TOTAL	54200
BPC GROUP REFINERIES	
BPC- MUMBAI	6900
NRL- NUMALIGARH	3000
KRL- KOCHI	7500
BPC TOTAL	17400
HPC GROUP REFINERIES	
HPC – MUMBAI	5500
HPC- VISAKHA	7500
HPC TOTAL	13000
ONGC GROUP REFINERIES	
MRPL- MANGALORE	9690
ONGC-TATIPAKA	78
ONGC TOTAL	9768
RIL – JAMNAGAR	33000
GRAND TOTAL	127368

3.43 Under the APM, production of public sector refineries was coordinated by the Oil Coordination Committee (OCC) keeping in mind regional product demand patterns. Post deregulation, refineries are free to determine their capacity utilization and yield patterns in accordance with the demand and realization of various petroleum products.

3.44 During evidence, the Committee expressed their concern about the fact that the actual cost of exploration and refining within the country or factors like inter-refinery differences in respect of crude oil, production pattern, size, complexities of refineries etc. were not being taken into account in the scheme of import parity pricing of products. The cost of a refined product was supposed to consist of about 90-95% crude cost and 5-10% refining cost. It was observed that the steep rise in global oil prices during 2004-05 had upset all such notions. To this, the Secretary, M/o Petroleum and Natural Gas replied as under:-

> "It is not that they earn a margin of twelve dollars throughout the year. It is fluctuating because it is dependent on the supply position and the scarcity position. The refineries have been quite uniformly having a good margin this year, but the figure is not going to be twelve dollars. They have been having a margin in the range of seven to eight dollars per

barrel throughout the year. That is the reason why they were able to generate more surplus funds. What we are saying is that, if these refineries were not there, then, we would have to import at that price…"

3.45 Refinery margins are usually related to cracked margins. A barrel of crude on distillation gives various components. The lighter fractions such as LPG, MS, ATF, kerosene, HSD, etc. command higher margins, whereas the heavier components such as FO, Asphalt, etc. command lower margins. Therefore, any refinery will attempt to procure the cheapest of crude i.e. the heavier one which has higher sulphur content and produce the lighter and middle distillates. Indian Public Sector refineries have higher yields of heavier ends, whereas the private sector refinery has a capacity to maximize lighter ends and middle distillates. Consequently the refining margins of the private sector refinery are far superior to that of public sector refineries.

3.46 When the Committee desired to know the details about the refining cost and refining margin of various refineries in the country, the Ministry of Petroleum and Natural Gas furnished the following data:

Rs./MT

Refinery	2003-04		2002-03		2001-02	
	Refining Cost	Refinery Margin	Refining Cost	Refinery Margin	Refining Cost	Refinery Margin
IOC						
Guwahati	1594	1824	2609	811	1465	-1398
Barauni	819	865	939	790	697	-168
Gujarat	328	1744	388	1414	372	543
Haldia	779	685	718	337	710	-0.12
Mathura	319	2057	318	2436	343	605
Panipat	414	1920	410	1812	427	243
Digboi	3140	2616	2402	2737	2286	-294
CPCL	597	1473	568	1397	405	682
BRPL	516	1685	716	2444	587	-309
BPC	483	1601	479	1350	474	858
KRL	394	1604	443	1490	466	868
NRL	937	1928	977	2247	858	896
HPCL						
Mumbai	581	1442	539	1010	494	634
Vizag	450	1559	485	1565	432	587
MRPL	646	1271	919	718	1365	626

The factors that generally lead to an increase in refinery margins are stated to be :-

- crude selection (proper crude mix),
- Import of Crude in larger parcels to improve economies of scale in respect of Freight, Landing Charges etc.,
- Higher spreads between Crude & Product prices dependent on international prices as well as Duty Protection,
- Enhance production of Value added products and
- Reduction of Cost.

3.47 Of all these factors, the higher spread between the crude and petroleum product prices in the international market has contributed the maximum towards increasing refinery margins domestically during 2004-05. It has been observed that in the international market, there exists a big divide between the cost of crude and the cost of products. There were times when the price of crude oil per barrel was US $ 40, whereas US $ 52 was the price of diesel per barrel. It means that US $12 was the margin in terms of the international market price itself. As per import parity system, the pricing of the products are being calculated in the country on the basis of this international price of the product which is a notional cost, though not an incurred one. This building up of prices on a notional basis, ultimately results in the ballooning of the prices of the products in the domestic market.

3.48 When the Committee wanted to know the percentage divide between the cost of crude and cost of refining in the price of refined products, the Ministry of P&NG furnished the following data:-

		Crude cost (%)	Refining cost(%)
IOC	2003-04	84.35	4.23
	2002-03	85.59	4.22
	2001-02	94.02	5.52
BPCL	2003-04	87.29	3.83
	2002-03	89.03	3.90
	2001-02	89.47	5.81
HPCL	2003-04	87.51	3.81
	2002-03	91.93	3.99
	2001-02	92.56	4.67
CPCL	2003-04	81.45	4.39
	2002-03	83.84	4.48
	2001-02	90.47	4.39
KRL	2003-04	87.18	3.80
	2002-03	88.06	3.87
	2001-02	89.94	5.82
NRL	2003-04	82.52	7.96
	2002-03	79.74	8.27
	2001-02	81.68	12.40
BRPL	2003-04	88.49	4.34
	2002-03	80.56	6.20
	2001-02	103.14	8.49
MRPL	2003-04	91.72	5.30
	2002-03	94.11	7.64
	2001-02	89.76	12.51

3.49 In response to a query by the Committee, the Ministry has also furnished the average Free on Board (FOB) price of Indian basket of crude, the price of indigenous crude and the respective prices of products like petrol, diesel, LPG and kerosene as given below:-

International prices of crude and petroleum products, retail price at Delhi

	International prices of Indian Basket Crude Oil and petroleum products					Retail selling prices at Delhi				
	Indian Basket Crude Oil	Unleaded Petrol	Diesel	Kerosene	LPG	Prices as on	Petrol	Diesel	PDS kerosene	Domestic LPG
Dolalr per barrel					Dollar per MT	Rs./ Litre				Rs./cylinder
Average 2002-03	26.67	30.15	28.93	29.32	280.00	1st April 2002	26.54	16.59	8.98	240.45
Average 2003-04	27.96	35.03	30.48	31.19	278.45	1st April 2003	33.49	22.12	8.98	241.20
Average 2004-05	39.22	49.01	46.91	49.50	368.52	1st April 2004	33.71	21.74	9.01	241.60
Average April – June, 2005 (prov.)	49.75	57.33	61.14	65.69	411.13	1st April 2005	37.99	28.22	9.05	294.75
						4th May 2005	37.99	26.45	9.05	294.75
						21st June 2005	40.49	28.45	9.05	294.75

- The Indian basket represents published FOB prices of crude oils average of Oman/ Dubai for sour crude oils and Brent (dated) for sweet crude oils in the ratio of 57:43.
- Diesel (0.50% sulphur) and kerosene prices are FOB of Arab Gulf Market.
- Petrol (unleaded 92 RON) Prices are FOB prices of Singapore Market.
- LPG prices given above are for Butane (60%) and Propane (40%). The FOB Prices are of Saudi Aramco.
- The international prices are as published by Platt's.

(E) Export and Import of Petroleum Products

Export of products

3.50 With the increase in the refining capacity over the years, India has emerged as a net exporter of petroleum products. The major products exported are diesel, petrol, naphtha, ATF and fuel oil. When asked to state whether some companies have been exporting refined petroleum products without marketing them within the country, the Ministry of Petroleum and Natural Gas stated as under:-

> Refining companies like RIL and MRPL have been exporting petroleum products especially transportation fuels MS, HSD and ATF without marketing them in the country as marketing rights for these fuels prior to deregulation of petroleum sector were available only to four oil marketing companies namely, IOC, BPC, HPC and IBP. Other products in surplus are also being exported. Product-wise exports of petroleum products in the last three years are given in the table below:

(in TMT)

Product	2001-02	2002-03	2003-04	2004-05
MS	2406	2336	2979	2836
Naphtha	2535	2067	2176	2926
ATF	194	697	1660	2428
HSD	2860	3178	6181	7001
FO	482	1120	1310	1781
Others	1608	891	315	555
Total	10085	10289	14620	17527

3.51 Duty drawback benefit in the form of Advance Licence enabling duty free import of raw material, is enjoyed by oil refineries for export of petroleum products. The benefit enjoyed is the customs duty saved on eligible quantity of crude oil imports against the advance licence. Advance Licence under Duty Exemption Scheme under the EXIM Policy is available for quantity of crude oil calculated as per the Standard Input Output Norms (SION), Under

SION Serial Nos. A2688 to A2690, eligible quantity of crude oil can be imported against the exports.

3.52 The approximate value of advance licence benefit availed on crude imports by oil companies are given as under:

Rs/ Crores

	2003-04	2004-05
IOCL	37.81	58.50
BPCL	57.70	70.11
MRPL	369.63	645.44
CPCL	42.05	84.17
KRL	45.29	101.50
HPCL	95.59	166.97
RIL	652.00	1568.00
TOTAL	1300.07	2694.69

3.53 The Committee wanted to know the total production of petroleum products of each company, the quantity exported and the percentage of exports during the said period. In reply, the Ministry of Petroleum and Natural Gas furnished the following:-

2004-05	Production	Exports	Percentage of Production Exported
	TMT	TMT	Percentage
IOC	34149	1202	3.5
BPC	8598	470	5.5
HPC	13078	930	7.1
MRPL	11063	4124	37.3
RIL	31904	10240	32.1
ONGC	2774	537	19.4

Import of Products

3.54 Though crude imports form about 70% of our requirements, product imports, especially petrol and diesel, are minimal. The details are as follows:-

PRODUCT IMPORT	2002-03		2003-04 Provisional		2004-05 Provisional			
Public Sector	Qty./ TMT	Value Rs./crore	Qty./TMT	Value Rs./crore	Qty./ TMT (original)	Value (original) Rs./crore	Revised Quality	Revised Value Rs./Crore
LPG	865	1568	1492	2246	2139	4055	2068	3942
Petrol					233	501		
Aviation Petrol	2	7	2	9	3	14		
Kerosene					210	429		
Aviation Turbine fuel								
Diesel					703	1422		
Naphtha	332	411	93	147	252	470		
Fuel oil	315	273	295	252	314	304		
P. wax								
Lubes	28	55	1	4				
LSWR								
MTBE					22	43		
Others								
Public Sector	1542	2314	1883	2658	3877	7239	3806	7126
Private Sector					4021		5021	
LPG	208	299	216	312	265	472		
Propane			450	592	588	987		
Naphtha	2452	3140	2278	2737	1962	3559		
Kerosene	698	808	804	890				
Diesel	106	119	100	116	111	181		
Fuel Oil	941	811	658	558	426	388		
Lubes	312	471	611	978	557	963		
Others	5	10						
CBFS			148	128	191	158		
RPO			11	9	11	10		
LSWR	964	875	775	740	845	1012		
Bitumen			6	5	21	17		
Coke					44	15		
P.wax			61	0.19	0.2	0.3		
Private sector	5686	6533	6118	7065	4021	7762		
Total product imports	7228	8847	8001	9723	8898	15001	8828	14887
Total imports	89217	85042	98435	93251	104759	132033	104689	131891

NOTES: Private imports as per industry assessment in the absence of any reliable system of collection of data.
PSU imports data as per IOC (IT), values of crude imports are on FOB basis except for C&F contracts

CHAPTER IV

INTERNATIONAL SCENARIO

A) Pricing of Petroleum Products world over

4.1 Till early nineties, only the developed economies of Europe, North America, Japan, Australia and the city States of Singapore and Hongkong had freed the price of transportation fuels. Among the developing countries, Thailand and Phillippines were the first ones who freed the prices of these products. In 2004, due to volatile international prices, Thailand re-introduced an `Oil Fund' for petrol and diesel.

4.2 When asked about developing countries which have gone for import parity pricing in spite of hundred per cent indigenous refining capacity, Ministry of Petroleum and Natural Gas informed that on the basis of the information available from Energy Information Administration (EIA) as of May, 2004, there are 54 developing countries other than India having refining capacity in excess of their consumption. But only Croatia, Phillipines and South Africa have gone in for import parity pricing, while retail selling prices in Malaysia and Turkey are determined by international market prices.

China

4.3 In China, it is understood that the Government agency called the National Reform and Development Commission (NRDC) announces benchmark (Intermediate) prices of petrol and diesel and the oil companies have the freedom to vary retail prices by +/- 8% over the benchmark prices. It is also understood that theoretically the benchmark prices are linked to international prices at markets in New York, Singapore and Rotterdam and also movement in the prices at these markets over a certain percentage should result in corresponding adjustment in the benchmark prices.

Thailand

4.4 In Thailand, petroleum industry was fully deregulated in August, 1991. Prior to deregulation, the system prevalent was similar to that in India. Retail prices of fuels like diesel, kerosene and LPG were kept at artificially low levels with subsidies and an Oil Price Stabilisation Fund (OPSF) was used to shield the customers from direct impact of oil price fluctuations. Subsidies continued to be given through Oil Fund and as per available details, the level of subsidy that was being compensated from the oil fund on diesel was about 40% towards the end of 2004. Government also has the freedom to freeze prices in unusual situations. In times of high prices, oil companies operate at lower margins while increasing retail prices marginally and vice versa.

Philippines

4.5 In Philippines, petroleum industry was fully deregulated in 1997 and oil companies are making regular adjustments in the selling prices. Profits are allowed to be market dependent. But this deregulation was done in a phased manner with rationalization of duties and taxes and the Government continued to maintain an Oil Price Stabilisation Fund till 1997.

Korea

4.6 The pricing for petrol and diesel is deregulated in Korea and oil companies have been making regular adjustments in their selling prices. However, as per policy, the Government makes the following interventions when prices of crude oil cross a certain threshold limit to ease the impact on the consumers:-

- Corrections in import duties and domestic taxes, like excise tax
- Impose price ceiling, release Strategic reserves and compensate loss to oil companies from Price Buffering Fund.
- Implement energy conservation measures and enlargement of incentives on voluntary energy conservation.

Malaysia

4.7 Since 1970s, the Malaysian petroleum industry had been dominated by the national oil and gas corporation Petronas as well as Shell along with ESSO, Mobil, BP and Caltex. The sector had been deregulated in 1983, except for automatic pricing mechanism to regulate retail selling prices for MS, HSD for transportation and LPG for domestic use. Lowest Singapore posted prices on the first day of the month determines pricing. Government fixes maximum selling prices for the products and the subsidies are provided on domestic LPG from the fiscal budget.

Japan

4.8 Oil prices in Japan are now market determined. Different prices prevail at the same market depending on the amount customers are willing to pay.

B) Petroleum Taxes Worldwide

4.9 Taxes on petroleum products vary across countries according to whether the country is a net exporter or a net importer of hydrocarbons. One common feature observed across countries is that fuel taxes are relatively easy to collect and constitute a buoyant and important source of revenue.

4.10 The highest fuel taxes are in the United Kingdom, with fuel taxes accounting for 78 per cent of the final price of motor spirit and HSD in March, 2001. Japan has a moderate taxation on transport fuels, and revenue therefrom dedicated to road construction. Kerosene, used for domestic heating and cooking, is taxed at concessional rates in many countries.

4.11 Most developing countries have differentials in taxes on fuels. Motor spirit is more heavily taxed than HSD for distributional reasons.

4.12 The percentage of taxes in the retail selling prices of some of the developing countries is as below:-

Item	% of tax to total price
Petrol	
Sri Lanka	37%
Thailand	24%
Pakistan	30%
Diesel	
Sri Lanka	20%
Thailand	15%
Pakistan	15%

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PART – II

RECOMMENDATIONS/ OBSERVATIONS OF THE COMMITTEE

1. Domestic crude oil production by Oil and Natural Gas Corporation Ltd. (ONGC) and Oil India Ltd. (OIL), the two national oil companies and private/ joint venture companies engaged in the exploration and production activities in the country accounts for only about 30% of the country's crude oil requirements while more than 70% of the same is met through imports from other countries. Consequent upon dismantling of the Administered Pricing Mechanism (APM), w.e.f 1.4.2002, the price of indigenous crude is being determined on the basis of crude oil agreements between the producers and the refiners by benchmarking various indigenous crude oils to equivalent international crude oils. This, the Committee understand, allows ONGC and OIL to charge import parity prices for the crude produced in India, by linking the prices to international crude prices. Components like ocean freight, insurance, customs duty, ocean loss, port dues, etc. are added to the Free on Board (FOB) price of the respective marker crude in the international market to calculate the import parity price of domestic crude. In the opinion of the Committee such factors which are in no way connected to domestic crude production should not go into calculating the price of domestic crude. The Committee, therefore, recommend that the Government should peg the price of domestic crude to the Free on Board (FOB) price of the respective marker crude in the international market.

2. Crude imports are generally done through commercial agreements or contracts named as term contracts entered into by various Indian companies with National Oil Companies of oil producing countries. Crude is also procured from open market on spot basis through tenders. The Committee find that during 2004-05, stand-alone refineries like Mangalore Refinery and Petrochemicals Ltd. (MRPL) and Kochi Refineries Ltd. (KRL) have got 98% and 75% of their respective crude imports done through term contracts. For BPCL, this share is 66% whereas for HPCL, IOC and its subsidiaries, this share comes to 62%. As term contracts are more flexible than spot tenders and long term uninterrupted supply of crude can be ensured through them, the Committee desire that the Government should ask all refining companies to enhance the share of procurement through term contracts.

3. The Committee note that cess and royalty form major components in the cost of production of indigenous crude oil. At present, cess is levied @ Rs.1800 per tonne under the provisions of Oil Industry Development Act, 1974. The Oil Industry Development Board (OIDB) was set up in 1975 under Oil Industry Development Act to provide financial assistance for the development of the Oil Industry. Annual cess collection amounts to nearly Rs. 5400 crore. The Committee have been informed that since the inception of OIDB and upto 31.3.2005, the Central Government has collected a sum of about Rs. 55966.81 crore as cess. Out of this collection, OIDB has received only Rs. 902.40 crore till March, 2005. The argument of Ministry of Finance is that the definition of "oil industry" encompasses all activities directly or indirectly connected with exploration, production, and marketing of mineral oil and production of fertilisers/petrochemicals. They have even stated that the expenditure on "oil

industry" has exceeded the cess collections. The Committee, dismiss this argument as a far-fetched one. It is highly regrettable that large funds collected for a specific purpose i.e. to carry out oil industry developmental activities are not utilised for that purpose. The Committee have already expressed their deep concern and strong objection to the practice of not adhering to the objectives of such a levy in their First and Fourth Reports (14^{th} Lok Sabha). The Committee again emphasise that there is no justification in levying cess if the amount generated from it is not being utilised for the sector and reiterate their earlier recommendation that a Price Stabilisation Fund should be created by using the money collected from cess on crude oil to bring in stabilisation in the prices of petroleum products. Besides, a part of the cess amount may also be utilised to provide subsidy on kerosene and LPG.

4. As regards royalty levied by State Governments in respect of the crude oil extracted from their respective jurisdictions, the Committee observe that the rates are substantial which result in enhancing the final cost of crude significantly. During the 90's, the royalty was collected at specific rates. Later, it was revised to an *ad valorem* rate of 20% of the well head price. At present, royalty is being levied at the rate of 20% of the well head price for onshore and shallow water offshore and 10% for offshore above 400 meters. Though the provisions of Oil Fields Regulation and Development Act, 1948 permit royalty collections upto 20% of well-head price, the Committee desire that the Government should persuade the State Governments to reduce the royalty rates so as to bring down the final cost of crude, thereby ultimately benefiting the

customer. If necessary, the Oil Fields Regulation and Development Act may be amended.

5. At present, the prices of petroleum products are being fixed on import parity basis which has replaced Administrative Pricing Mechanism of yester years. Import parity means the price that an actual importer would have paid for the import of the product. Accordingly, the refinery gate prices of products, i.e. the prices at which the marketing division of an oil company or an oil marketing company purchases the product from refining division or a refinery are calculated by adding ocean freight, insurance, customs duty, ocean loss, port charges, etc. to the Free on Board (FOB) price of the respective product in the international market. Though the basic price at the refinery gates calculated on import parity basis are uniform at all refineries throughout the country, the retail selling prices of the products for the consumer is computed by adding excise duty, freight up to depots, marketing cost/ margin, state specific irrecoverable levies, delivery charges from depot to retail pump outlets, sales tax/ other local levies and dealers' commission to this basic price. Thus, the system artificially inflates the prices of petroleum products refined at home. The Committee strongly feel that the pricing of products on import parity basis is irrational and far removed from reality as the computations are made on assumed costs. Though the input for refineries is crude, the price of the output is based on the international price of the respective product. As almost all the components that go into calculating the refinery gate price of products are notional components without any incurred cost basis, the Committee recommend that the Government should scrap the import parity pricing method for products and instead should go in for a more realistic method. The Government can explore the option of pegging the product prices to FOB price of products prevailing in the global market, which is the price realization refineries abroad get and would be the net realization of oil companies if they were to export.

6. The Committee also note that the actual cost of refining and the refinery margin within the country are not taken into account in the pricing of products. The average refining costs of stand-alone refineries like KRL and MRPL were 59 paise and 64 paise per litre, respectively, during 2004-05. The refinery margin fluctuates in accordance with global prices. The Committee further understand that the price differential between crude and the respective product in the international market results in huge refinery margins. During 2004-05, the average differential between the international price of Indian basket of crude oil and petrol was $ 9.79 per barrel whereas it was $ 7.69 per barrel for diesel during the same period. The Committee also find a consistent rise in refinery margins and consistent reduction in refining costs in respect of almost all the refineries in the three years from 2001-02 to 2003-04. But despite having reduced refining costs in the country, the final prices of products are arrived at taking into account a whole lot of notional costs which boost the refinery margins. The Committee also find that the gross refinery margin varies from refinery to refinery in the country depending on the ability to process heavier and cheaper source of crude, potential to enhance the production of value added products, the technology employed and the total production capacity of the refinery. The Committee, therefore, recommend that a realistic ceiling should be worked out for the refinery margins. Assistance of Tariff Commission in working out the actual refining cost especially in private refineries should be sought.

7. During the examination of Demands for Grants (2005-06) of the Ministry of Petroleum and Natural Gas, the Committee had expressed apprehension that the added burden on excise front would be passed on to the consumer in the name of exorbitant rise in international prices of petroleum products. The said apprehension seems to have come true as the Committee find that in the recent hike of Rs. 2.50/litre in case of petrol and Rs. 2/litre for diesel, the substantial contribution has been made by the enhanced rates of excise duties. Fox example, out of Rs. 2.50 hike in petrol, the contribution of enhanced rates of excise duties has been Rs. 2.20. Similarly, in Rs. 2 hike of diesel, the enhanced excise duty component has contributed Rs. 1.06. The increase in prices because of global oil price surge is nil in case of petrol and Rs. 0.70 in case of diesel. Quality improvement programmes account for the remaining part of the hike in prices. Thus, the recent price rise was mainly due to changes in excise duties on products effected through the Union Budget of 2005-06 and not due to rise in international crude prices. Considering the fact that increase in fuel prices, especially diesel, would have a cascading effect on the prices of various essential commodities affecting the common man at large, the Committee recommend that the increase in prices of such products should be kept at the minimum.

8. As regards excise duties on products, the Committee understand that there exists a multitude of excise duties on petrol and diesel. At present, the excise duty of petrol has a specific, *ad valorem* mix of 8% + Rs. 13/ litre. This includes a basic excise duty content, additional excise duty to fund road construction, a special excise duty component and a special additional excise

duty as surcharge for national highway project. In the case of diesel, apart from basic excise duty, there exists an additional excise duty . Consequently, the Committee find that 36% of the retail selling price of petrol and 17% of that of diesel comprises excise duty component. This means, Rs. 14.74 out of Rs. 40.49 in the retail price of petrol and Rs. 4.93 out of Rs. 28.45 of diesel in Delhi owe to the excise component alone. The Committee find this as a highly disturbing trend. More disturbing is the *ad valorem* component of the excise duty which makes the burden on the consumer more prominent. The Committee, therefore, recommend that the excise duties on petroleum products be so structured as to ensure that the interests of the consumer are not compromised. The Committee also recommend that the *ad valorem* component in the existing mix should be replaced by a single specific component.

9. The Committee note that the various taxes and duties levied on products are responsible for their higher retail selling prices. As of now, taxes which comprise customs, excise and State level duties are about 132% of the basic price of the products in the country. The Committee also find that among the developing countries, India has a higher share of taxes in the retail selling prices of products in comparison to most other countries. The share of taxes in the selling price of petrol in Sri Lanka, Thailand and Pakistan is 37%, 24% and 30% respectively. In the case of diesel, the other countries have kept the taxes to less than 20%. Out of the retail price of petrol in Delhi, 57% is tax component. For diesel this component is 35%. Thus, the tax component or the non-fuel component results in exorbitant prices of these products. The Committee,

therefore, recommend that the total share of taxes and duties in the retail selling prices of commonly used fuels including auto fuels should be rationalised.

10. Regarding customs duties , the Committee understand that the levy is only a mechanism to ensure fruitful gains to refining companies. The customs duty levied on products does not actually add to the revenues of the Government as product imports are almost nil owing to surplus refining capacity in the country. Instead, it goes into the calculations for fixing the import parity prices of these products at refinery level which in turn increases the consumer price. Moreover, any differential between the customs duty on crude and the customs duty on products will increase the effective tariff protection of the refineries. The Committee, therefore, recommend that the customs duty on products, especially that on petrol and diesel, be brought down to 5 per cent from 10 per cent, to make it on par with the customs duty on crude, leaving no room for any differential at this level. Tariff protection to the public sector refineries can be ensured through rationalisation of excise duty to take care of this factor as explained earlier in paragraph 8.

11. The Committee find that the high incidence of State levies are mostly responsible for the high and varied retail selling prices of different products across the country. For example, the sales tax on diesel in Mumbai is close to 37.97% as against 12.5% in Delhi. The differential in the sales tax on petrol in Andhra Pradesh and Delhi is as high as 14%. In the opinion of the Committee, there is a need to substantially reduce the sales tax rates of petroleum products

and also to make them uniform across the country. They, therefore recommend that the Central Government should seriously take up these matters at appropriate level with the States and bring them to a consensus to reduce sales taxes considerably to a uniform floor rate.

12. It is seen that the Centre and States have been collecting huge revenues from the petroleum sector. During 2004-05, a gross revenue earning of Rs. 1,20,946 crore has been made by them from Petroleum, Oil and Lubricants (POL) of which Rs. 77,692 crore has been the contribution to Central exchequer and Rs. 43,254 crore to the State coffers. The Committee also find that the percentage share of petroleum sector through taxes and duties to the gross revenue of the Government is 64%. The Committee find that the Governments have a tendency to bank heavily on this sector to mobilise revenues. They, therefore, reiterate their earlier recommendation made in their Fifth Report (14th Lok Sabha) that the practice of squeezing the maximum out of the sector without concern for the common man needs to be changed. The Committee once again urge the Government to exercise restraint and apply the policy of prudence in making earnings from the oil sector.

13. Under the scheme of subsidy on domestic LPG and PDS kerosene, the Government is providing subsidy on these items. During the Administered Pricing Mechanism (APM) period i.e. upto 31.3.2002, domestic LPG and PDS kerosene were being cross-subsidised through the Oil Pool Account. After the dismantling of the APM w.e.f. 1.4.2002, the Government subsidy is being decided on flat rate basis. After providing for this subsidy, the retail prices are

to vary as per changes in the international market. As the Governmental subsidy provisions are minimal, the Committee find that the public sector Oil Marketing Companies (OMCs) have been shouldering a part of the subsidy by not passing the full increase in the international prices to the domestic consumer. This, they do, by selling at prices that fall short of import parity prices, thereby suffering under-recoveries. Besides, the Committee also find that upstream oil majors viz. ONGC and OIL and GAIL are also sharing this subsidy in the form of special discounts to PSU oil companies engaged in the business of marketing of products. The Committee are of the view that this net of subsidy sharing needs to be widened by including all the refineries (both public and private sectors) in the country, considering the gains made by them within the existing system of pricing. The Committee, while reiterating the need to continue the subsidy on PDS kerosene and domestic LPG, recommend for an improved delivery mechanism, targeted at real beneficiaries, leaving no room for misappropriation or misuse.

14. The Committee find that surplus refining capacity has enabled the country to be a net exporter of petroleum products like diesel, petrol, naphtha, ATF, etc. For export of petroleum products duty drawback incentive is being given by the Government. The scheme allows exemption of customs duty on crude in lieu of petro goods exported. In other words, exporting companies are exempted from paying customs duty on part of their crude imports in lieu of their export earnings. Under the scheme, the Finance Ministry forgoes customs revenue and the exporting companies benefit immensely, both by the duty

concession and the exorbitant global prices for their products. The Committee do not agree to such a concession, when huge international prices alone can take care of the profit of the exporters. The Committee, therefore, recommend that the Government should withdraw the duty drawback incentive for export of petro goods. The Government can then make use of the revenue gains on customs front to bring down the excise duties on fuel and thus, pass on the benefit enjoyed by the exporters to the consumers in line with the stated policy of equitable distribution of burden.

15. The Government should explore on top priority the development of alternative energy resources to reduce dependence on heavy imports. Coal being our major energy source, Government should make specific plans to enhance Coal Bed Methane production, Coal gassification, Coal cleaning technology etc. Technology upgradation or import of technology in this regard should be on the priority. Adequate attention may also be given to the use of ethanol blending.

NEW DELHI
August 1, 2005
Sravana 10, 1927(Saka)

N. JANARDHANA REDDY,
Chairman,
Standing Committee on
Petroleum and Natural Gas

<u>APPENDIX - I</u>

MINUTES

STANDING COMMITTEE ON PETROLEUM AND NATURAL GAS
(2004-05)

FIFTH SITTING
(07.10.2005)

The Committee sat on Thursday, October 7, 2004 from 1100 hrs. to 1230 hrs. in Committee Room `E', Parliament House Annexe, New Delhi.

PRESENT

Shri N. Janardhana Reddy - Chairman

MEMBERS

Lok Sabha

32. Dr. Rattan Singh Ajnala
33. Shri Ramesh Bais
34. Shri Kirip Chaliha
35. Shri Lal Muni Choubey
36. Shri R. Dhanuskodi Athithan
37. Shri Santosh Kumar Gangwar

38. Shri Jai Prakash
39. Shri Ch. V.H. Rama Jogaiah
40. Shri Suresh Kurup
41. Shri Vanlalzawma
42. Shri Rajesh Verma
43. Shri A.K.S. Vijayan

Rajya Sabha

44. Shri Rajeev Shukla
45. Shri Dipankar Mukherjee
46. Shri Subash Prasad Yadav
17. Shri Satish Chandra Misra

Secretariat

1.	Shri P.D.T. Achary	-	Additional Secretary
2.	Shri P.K. Grover	-	Director
3.	Shri B.D. Swan	-	Under Secretary
4.	Shri P.C. Tripathy	-	Assistant Director

Representatives of Ministry of Petroleum and Natural Gas and Public Sector Undertakings

1.	Shri M.S. Srinivasan	-	Additional Secretary
2.	Shri Prabh Das	-	Joint Secretary
3.	Shri S. Vijayaraghavan	-	Director, PPAC
4.	Shri Ram Singh	-	Director (Fin.), PPAC
5.	Shri C.K. Sengupta	-	Executive Director, BPCL
6.	Shri C. Ramulu	-	Director (Fin.), HPCL
7.	Shri P. Sugavanam	-	Director (Fin.), IOCL

2. At the outset, the Hon'ble Chairman welcomed the Additional Secretary of the Ministry of Petroleum and Natural Gas and other accompanying officials to the sitting of the Committee.

3. Thereafter, the Committee were briefed by the representatives of the Ministry/PSUs on the subject `Pricing of Petroleum Products'. During the course of the briefing, the Members were enlightened on various issues relating to the subject such as frequent price revisions of petroleum products, variation in sales

tax levied on petroleum products, impact of global crude prices on the prices of petroleum products, subsidy on domestic LPG and PDS kerosene, under-recoveries of PSUs on account of such subsidy, etc.

4. A verbatim record of the proceedings has been kept.

The Committee then adjourned.

APPENDIX - II

MINUTES

STANDING COMMITTEE ON PETROLEUM AND NATURAL GAS
(2004-05)

NINTH SITTING
(11.01.2005)

The Committee sat on Tuesday, January 11, 2005 from 1100 hrs. to 1315 hrs. in Committee Room `C', Parliament House Annexe, New Delhi.

PRESENT

Shri N. Janardhana Reddy - Chairman

MEMBERS

Lok Sabha

2. Shri Anandrao Vithoba Adsul
3. Dr. Rattan Singh Ajnala
4. Shri Ramesh Bais
5. Shri Lal Muni Choubey
6. Shri Tushar A. Choudhary
7. Shri R. Dhanuskodi Athinan
8. Shri Santosh Kumar Gangwar
9. Shri Ch. V.H. Rama Jogaiah
10. Shri Suresh Kurup
11. Shri Sukhdeo Paswan
12. Shri Rajiv Ranjan Singh
13. Shri Ramji Lal Suman

14. Shri Vanlalzawma
15. Shri Rajesh Verma
16. Shri A.K.S. Vijayan

Rajya Sabha

17. Shri Rajeev Shukla
18. Shri Kripal Parmar
19. Shri M. Rajasekara Murthy
20. Shri Dipankar Mukherjee
21. Shri C. Perumal

Secretariat

1.	Shri P.D.T. Achary	-	Secretary
2.	Shri P.K. Grover	-	Director
3.	Shri B.D. Swan	-	Under Secretary
4.	Shri PC. Tripathy	-	Asstt. Director

Representatives of Ministry of Petroleum and Natural Gas and Public Sector Undertakings

1.	Shri S.C. Tripathi	-	Secretary, P&NG
2.	Shri Prabh Das	-	Joint Secretary, P&NG
3.	Shri M.S. Ramachandran	-	Chairman, IOCL
4.	Shri Ram Singh	-	Director (Finance), PPAC
5.	Shri S. Vijayaraghavan	-	Director, PPAC
6.	Shri C. Ramulu	-	Director (Finance), HPCL
7.	Shri R.S. Sharma	-	Director (Finance), ONGC

8. Shri N.K. Mitra - Director (Marketing), ONGC

2. At the outset, the Hon'ble Chairman welcomed the Secretary of the Ministry of Petroleum and Natural Gas and other accompanying officials to the sitting of the Committee.

3. Thereafter, the Committee took oral evidence of the representatives of the Ministry of Petroleum and Natural Gas on the subject `Pricing of Petroleum Products'. During the course of evidence, important issues relating to the subject were discussed viz. import parity concept in the pricing of petroleum products, exploration/ refining by private sector companies, the allocation of funds to Oil Industry Development Board from the Cess collected over the years, under recoveries of oil PSUs on account of subsidies given on LPG and kerosene, transit loss of fuels, the need to have a price stabilization fund etc.

4. A verbatim record of the proceedings has been kept.

The Committee then adjourned.

APPENDIX - III

EXTRACTS OF MINUTES

STANDING COMMITTEE ON PETROLEUM & NATURAL GAS

(2004-05)

ELEVENTH SITTING
(16.02.2005)

The Committee sat from 1100 hrs. to 1245 hrs.

PRESENT

Shri N. Janardhana Reddy - Chairman

MEMBERS

LOK SABHA

1. Shri Kirip Chaliha
2. Shri Lal Muni Choubey
3. Shri R. Dhanuskodi Athithan
4. Shri Santosh Kumar Gangwar
5. Shri Jai Prakash
6. Dr. Prasanna Kumar Patasani
7. Shri Rajesh Verma
8. Shri A.K.S. Vijayan

RAJYA SABHA

9. Shri Moolchand Meena
10. Shri Rajeev Shukla
11. Shri Kripal Parmar
12. Shri M. Rajasekara Murthy
13. Shri Dipankar Mukherjee
14. Shri C. Perumal

SECRETARIAT

1.	Shri P.D.T. Achary	-	Secretary
2.	Shri P.K. Grover	-	Director
3.	Shri P.C. Tripathy	-	Assistant Director

Evidence of the Representatives of the Ministry of Petroleum and Natural Gas and Public Sector Undertakings on the subject `Exploration of Oil and Natural Gas including Coal Bed Methane'

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xx xx xx xx xx xx

Evidence of the non-official witness Shri H.L. Zutshi, Ex-CMD, HPCL on the subject `Pricing of Petroleum Products' .

7. Thereafter, the non-official witness (Shri H.L. Zutshi, Ex-CMD, HPCL) was called in.

8. The Chairman welcomed the non-official witness.

9. The non-official witness gave a presentation highlighting various issues relating to the subject 'Pricing of Petroleum Products'. Several points were discussed during the oral evidence of the non-official witness which included dismantling of the Administered Pricing Mechanism (APM), background of the mechanism for pricing of petroleum products, system of the erstwhile Oil Pool Accounts, import parity pricing system, refining margins in the pre-APM and post-APM era, benefits accruing to the producing companies and refineries after deregulation, international crude prices, levy of specific duty instead of *ad valorem* duty on petroleum products, subsidy on PDS kerosene and Domestic LPG, etc.

10. A verbatim record of the proceedings of the sitting has been kept.

The Committee then adjourned.

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xx Matters not related to this Report.

<u>APPENDIX - IV</u>

MINUTES

STANDING COMMITTEE ON PETROLEUM AND NATURAL GAS
(2004-05)

FOURTEENTH SITTING
(05.05.2005)

The Committee sat on Thursday, May 5, 2005 from 1530 hrs. to 1700 hrs. in Committee Room `E', Parliament House Annexe, New Delhi.

PRESENT

Shri N. Janardhana Reddy - Chairman

MEMBERS

Lok Sabha

2. Shri Tushar A. Choudhary
3. Shri Vanlalzawma
4. Shri Rajesh Verma

Rajya Sabha

5. Shri Dipankar Mukherjee
6. Dr. Alladi P. Rajkumar

Secretariat

1. Shri S.K. Sharma - Additional Secretary
2. Shri P.K. Grover - Director
3. Shri P.C. Tripathy - Under Secretary

Non-official witnesses

1. Shri U. Sundararajan - Ex-CMD, BPCL
2. Shri B.C. Bora - Ex-CMD, ONGC

2. At the outset, the Chairman welcomed the non-official witness (Shri U. Sundararajan, Ex-CMD, BPCL) to the sitting of the Committee and explained the purpose of the sitting.

3. The non-official witness then gave a brief presentation touching upon various issues relating to the subject `Pricing of Petroleum Products'. The points discussed during the oral evidence included the dismantling of Administered Pricing Mechanism (APM), import parity pricing system, refining margins/ actual refining costs of refineries, tax component in the pricing of petroleum products etc.

4. The Committee also took oral evidence of another non-official witness (Shri B.C. Bora, Ex-CMD, ONGC). This non-official witness also shared his views on the pricing of crude/ petroleum products, hydrocarbon reserves in the country vis-à-vis other countries and highlighted the need to develop alternative sources of hydrocarbons to ensure energy security for the country.

5 A verbatim record of the proceedings of the sitting has been kept.

The Committee then adjourned.

APPENDIX - V

MINUTES

STANDING COMMITTEE ON PETROLEUM AND NATURAL GAS

(2004-05)

FIFTEENTH SITTING
(21.06.2005)

The Committee sat on Tuesday, June 21, 2005 from 1100 hrs. to 1245 hrs. in Committee Room `D', Parliament House Annexe, New Delhi.

PRESENT

Shri N. Janardhana Reddy - Chairman

MEMBERS

Lok Sabha

2. Dr. Rattan Singh Ajnala
3. Shri Ramesh Bais
4. Shri Kirip Chaliha
5. Shri Lal Muni Choubey
6. Shri Tushar A. Choudhary
7. Shri R. Dhanuskodi Athithan
8. Shri Santosh Kumar Gangwar
9. Shri Ch. V.H. Rama Jogaiah
10. Shri Suresh Kurup
11. Dr. Prasanna Kumar Patasani
12. Shri Laxman Singh
13. Shri Rajiv Ranjan Singh

14. Shri Ramji Lal Suman
15. Shri Vanlalzawma
16. Shri Ratilal Kalidas Varma
17. Shri Rajesh Verma
18. Shri A.K.S. Vijayan

Rajya Sabha

19. Shri Moolchand Meena
20. Shri Rajeev Shukla
21. Shri M. Rajasekara Murthy
22. Shri Dipankar Mukherjee
23. Shri C. Perumal
24. Dr. Alladi P. Rajkumar

Secretariat

1. Shri P.D.T.Achary	-	Secretary
2. Shri P.K. Grover	-	Director
3. Shri P.C. Tripathy	-	Under Secretary

Representatives of the Ministry of Petroleum and Natural Gas and Public Sector Undertakings

1.	Shri S.C.Tripathi	-	Secretary
2.	Shri Prabh Das	-	Joint Secretary
3.	Shri Subir Raha	-	CMD, ONGC
4.	Shri S. Behuria	-	CMD, IOC

2. At the outset, the Chairman welcomed the Secretary of the Ministry of Petroleum and Natural Gas and accompanying officials to the sitting of the Committee and explained the purpose of the sitting. The Chairman also

expressed displeasure of the Committee over the delay caused by the Ministry in furnishing the written replies to the points raised by the Committee.

3. The Secretary, then, gave a brief presentation touching upon various issues relating to the subject `Pricing of Petroleum Products'. Thereafter, the Committee took oral evidence on the subject. The major points discussed during the oral evidence included import of crude, the components of the recent price hike of petrol and diesel, central /state taxes levied on petroleum products, need to restructure excise duty on petroleum products, refining cost and refining margin of refineries, concept of reasonable profit to refiners/upstream companies, creation of a Price Stabilization Fund, Planning Commission's observations on the policy regarding pricing of petroleum products, the procurement of different types of crude, etc.

4. A verbatim record of the proceedings of the sitting has been kept.

The Committee then adjourned.

APPENDIX - VI

MINUTES

STANDING COMMITTEE ON PETROLEUM AND NATURAL GAS
(2004-05)

SEVENTEENTH SITTING
(01.08.2005)

The Committee sat on Monday, August 1, 2005 from 1530 hrs. to 1630 hrs. in Committee Room `C', Parliament House Annexe, New Delhi.

PRESENT

Shri N. Janardhana Reddy - Chairman

Members

Lok Sabha

2. Shri Anandrao Vithoba Adsul
3. Shri Tushar A. Choudhary
4. Shri R. Dhanuskodi Athinan
5. Shri Santosh Kumar Gangwar
6. Shri Jai Prakash
7. Shri Sukhdeo Paswan
8. Shri Laxman Singh
9. Shri Vanlalzawma

Rajya Sabha

10. Shri Rajeev Shukla
11. Shri M. Rajasekara Murthy
12. Shri Dipankar Mukherjee

Secretariat

1.	Shri S.K. Sharma	-	Additional Secretary
2.	Shri P.K. Grover	-	Director
3.	Shri P.C. Tripathy	-	Under Secretary

2. At the outset, Hon'ble Chairman welcomed the Members to the sitting of the Committee.

3. Thereafter, the Committee condoled the death of persons in the recent fire at ONGC platform in Mumbai High North. The Committee appreciated the rescue operations carried out by various agencies. They also desired to have a detailed factual note from the Ministry of Petroleum and Natural Gas on this incident.

4. The Committee then took up for consideration the draft Reports on the subjects `Pricing of Petroleum Products' and `Exploration of Oil and Natural Gas including Coal Bed Methane' one by one.

5. After some discussions, the draft Report on `Pricing of Petroleum Products' was adopted by the Committee with some changes. The draft Report on `Exploration of Oil and Natural Gas including Coal Bed Methane' was adopted without any change.

6. The Committee also authorised the Chairman to finalise the Reports after factual verification by the concerned Ministry and present the same to both the Houses of Parliament in the current Session.

The Committee then adjourned.