

INFORMATION BULLETIN

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DIESEL FUEL : DEMAND, SUBSIDY AND PRICING

DEMAND OF DIESEL FUEL IN THE ECONOMY

Diesel fuel, one of the major components of petroleum fuels, assumes enormous significance in keeping the economy moving forward. Diesel is consumed for a variety of purposes in the economy. India relies heavily on imported crude oil (the principal raw material) for the production of diesel. This gives rise to a host of concerns including pricing mechanism which, on the one hand, influences technology adoption and resource allocation, and on the other, impacts current account and fiscal balances. As a consequence, price of diesel and efforts to maintain its uninterrupted availability always engages the attention of the policy makers.

Among the existing fuels, diesel presents applications across a wide variety of uses in India. Energy obtained from burning of diesel is primarily utilised for the following:

- Transportation: (i) Goods: railways (freight), maritime (carriers, liners), military vehicles, heavy and light commercial vehicles; (ii) Passenger: railways, roadways [buses, personal vehicles (cars, utility vehicles)], waterways (motor-boats, steamers, ferries, catamarans, yachts, cruise ships);
- Power Generation: power plants, industrial captive power, back-up generators (large commercial and residential units);
- Industrial Equipment;
- Farm Equipment; and
- Military Equipment.

Diesel is used in activities that together account for about two-fifths of the country's GDP. Diesel constitutes about 44 per cent of total consumption of petroleum products in India. 65 per cent of diesel is utilised in transportation sector that accounts for about 6.6 per cent of the GDP. Close to four-fifths of diesel is sold from retail outlets, and consequently the impact of price changes are rapidly transmitted in the economy. It is particularly disconcerting when large chunks of the economy operate

in unorganized sector, which, in India, encompass almost the entire agricultural sector, a large proportion of both passenger and goods transportation by road, and industrial enterprises.

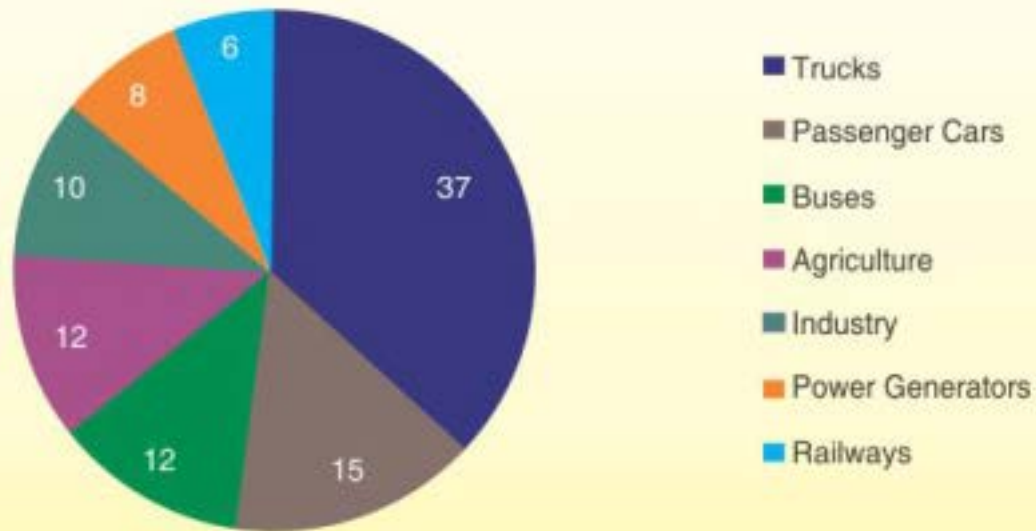
Fossil fuels, especially petroleum products, occupy a pre-eminent position in all economies across the world. As an essential input for economic activity, they, therefore, necessitate continued involvement of the Government. In the last few years, Indian economy has emerged as one of the fastest growing economies in the world. Growth in economic activity in India today largely determines increase in energy use and, by corollary, consumption of petroleum products. But, consumption of different fuels grows at differing rates and, as such, their share in total consumption of fuels changes accordingly.

Oil and gas together constitute 37.8 per cent of India's current energy consumption. Of this, the share of oil is 29 per cent. The share of diesel in the oil consumption is nearly 44 per cent. The consumption pattern of diesel across various sectors of the Indian economy is as follows:

Table-1: Sector-wise Consumption Pattern of Diesel in India

Sl.No.	Sector/User Category	Consumption (%)
1.	Trucks	37
2.	Passenger Cars	15
3.	Buses	12
4.	Agriculture	12
5.	Industry	10
6.	Power Generators	8
7.	Railways	6
Total		100

Graph-1: Consumption Pattern of Diesel (%)



With the gap in the prices of petrol and diesel widening ever since the decontrol of petrol prices effected in June 2010, the growth of diesel consumption has increased. The growth in diesel consumption during 2011-12 had been 7.80 per cent which was higher than the rate of

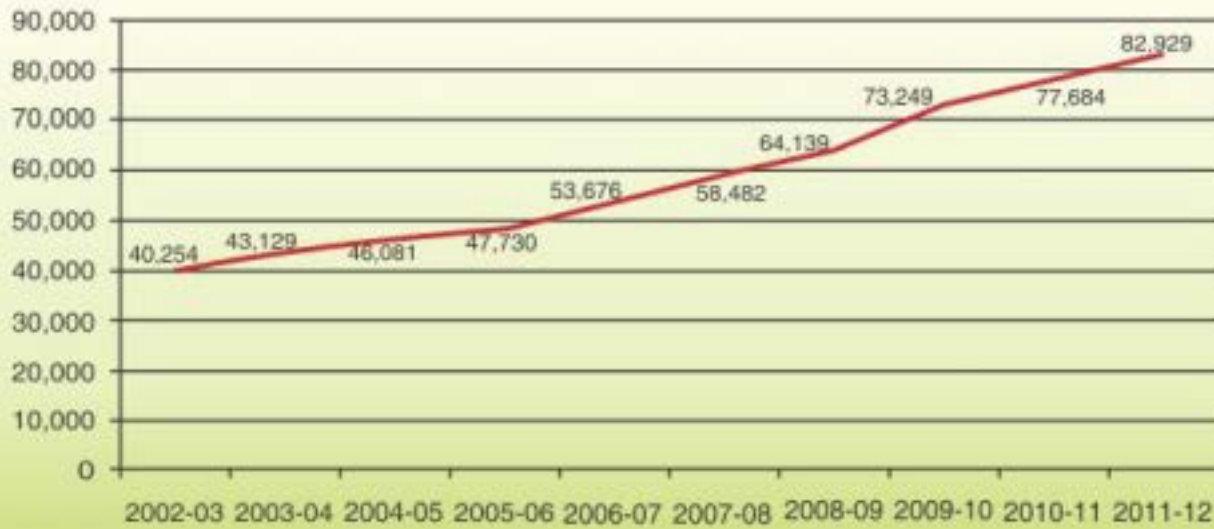
growth of 6.80 per cent registered in 2010-11. On the contrary, the growth in consumption of petrol declined from 10.70 per cent in 2010-11 to 5.60 per cent in 2011-12. The details of production, import, export and consumption of diesel in India since 2002-03 are given in Table-2:

Table-2: Production, Import, Export and Consumption of Diesel in India since 2002-03

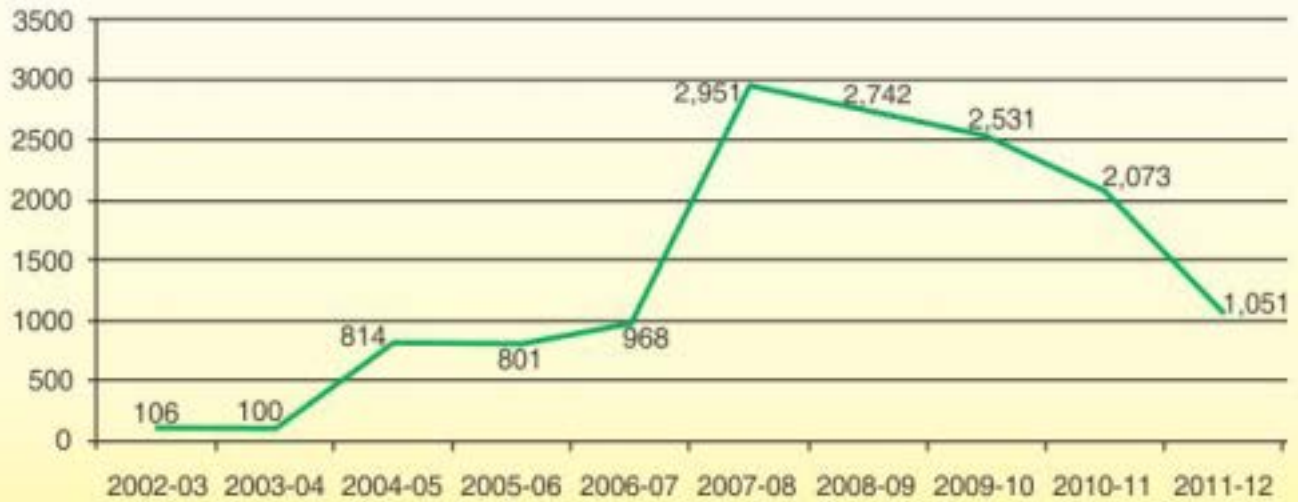
Year	Production of Diesel (1,000 Metric Ton)	Import of Diesel (1,000 Metric Ton)	Export of Diesel (1,000 Metric Ton)	Diesel Consumption (1,000 Metric Ton)	Growth in Consumption of Diesel (Percentage)
2002-03	40,254	106	3,178	36,645	0.3%
2003-04	43,129	100	6,181	37,074	1.2%
2004-05	46,081	814	7,286	39,650	6.9%
2005-06	47,730	801	8,504	40,191	1.4%
2006-07	53,676	968	11,369	42,896	6.7%
2007-08	58,482	2,951	14,308	47,669	11.1%
2008-09	64,139	2,742	14,720	51,710	8.5%
2009-10	73,249	2,531	18,451	56,242	8.8%
2010-11	77,684	2,073	20,335	60,071	6.8%
2011-12	82,929	1,051	20,407	64,750	7.8%
April-Sept. 2012*	43,909	567	9,630	34,175	10.5%

*Provisional.

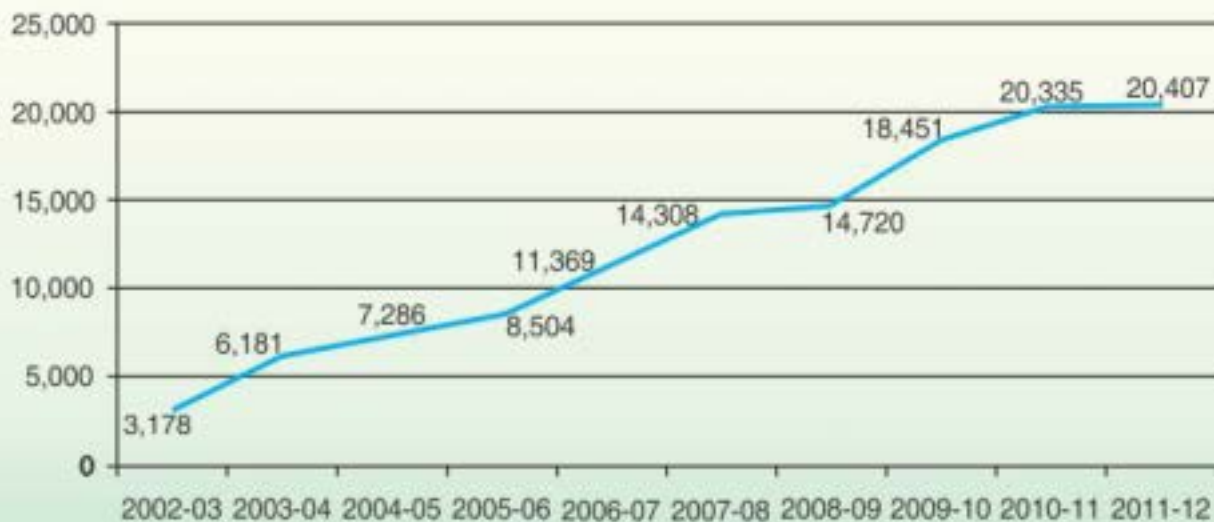
Graph-2: Production of Diesel (Thousand Metric Ton)



Graph-3: Import of Diesel (Thousand Metric Ton)



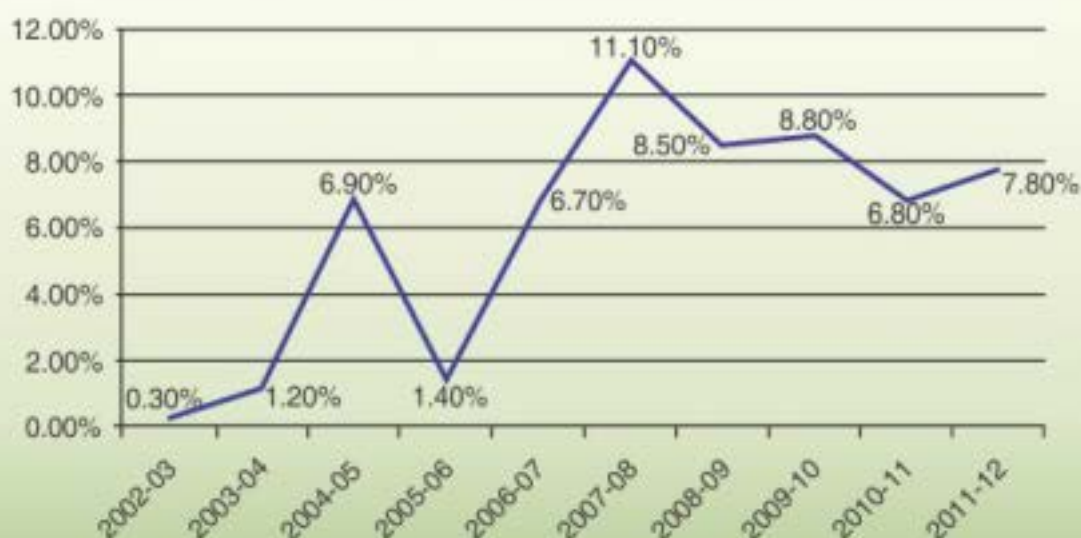
Graph-4: Export of Diesel (Thousand Metric Ton)



Graph-5: Consumption of Diesel (Thousand Metric Ton)



Graph-6: Growth in Consumption of Diesel (%)



PRICING OF DIESEL

During the period from 1976 to 2002, based on the recommendations of the Expert Committees, the pricing of petroleum products was brought under the Administered Pricing Mechanism (APM) which was based on 'cost plus' principle under which all kinds of cost (pricing, refining, marketing, etc.) are included. However, APM was found to be increasingly unsuitable for the long term growth and efficiency of the oil industry. Therefore, the Government constituted a Strategic Planning Group on Restructuring of the Oil Industry (R-Group) for developing a financially

sound and internationally competitive hydrocarbon sector. Based on the Report of the R-Group (September 1996), the Government decided to abolish APM in a phased manner during the period from April 1998 to March 2002 and the 'cost plus' pricing of petroleum products was replaced with the Import Parity Pricing (IPP)¹. Subsequently, in June 2006, based on the recommendations of the Expert Committee headed by Dr. C. Rangarajan, the Government changed the pricing of petrol and diesel from Import Parity Pricing to Trade Parity Pricing (TPP)² i.e. 80 per cent of Import Parity Price and 20 per cent of Export Parity Price (EPP)³.

¹ Import Parity Price (IPP): Import Parity Price represents the price that importers would pay in case of actual import of Diesel at the respective Indian ports.

² Trade Parity Price (TPP): Trade Parity Price is 80 per cent of Import Parity Price and 20 per cent of Export Parity Price w.e.f. 16.6.2006 as per the recommendations of the Rangarajan Committee Report.

³ Export Parity Price (EPP): Export Parity Price represents the price which oil companies would realize on export of diesel i.e. FOB price of product plus Advance License Benefit (ALB) (for duty free import of crude oil pursuant to export of refined products). Consequent to abolition of Customs Duty on Crude oil w.e.f. 25.06.2011, the ALB is currently Nil.

The price of diesel is built up taking into consideration a number of factors. The details of how the price of diesel

per litre is built up at Delhi for retail outlets are given in Table-3:

Table-3: Price Build-up of Diesel (with Element-wise explanation) at Delhi Retail Outlets

Sl. No.	Elements	Unit	w.e.f. 16th February 2013
1.	FOB AG Price for Gasoil 0.05% Sulphur [FOB Price: FOB (Free on Board) daily quotes of Gasoil at Arab Gulf including premium/discount published by Platts and Argus publications are averaged for previous fortnight.]	\$/bbl	129.79
2.	Trade Premium AG Price for Gasoil 0.05% Sulphur	\$/bbl	2.65
3.	Derived Quality Premium for BS-III Grade	\$/bbl	0.28
4.	Ocean Freight from AG to Indian Ports [Ocean Freight: Ocean freight from Arab Gulf to destination Indian ports as per World Scale freight rate adjusted for AFRA.]	\$/bbl	2.17
5.	C&F (Cost & Freight) OR Price (Sum of 1 to 4)	\$/bbl Rs./Litre	134.89 44.78
6.	Import Charges [Import Charges: Insurance charges, Ocean Loss, Letter of Credit (LC) Charges & Port dues applicable on import of product.]	Rs./Litre	0.41
7.	Customs Duty [Customs Duty: Customs duty on diesel is 2.50% + 3% Education cess.]	Rs./Litre	1.17
8.	Import Parity Price (Sum of 5 to 7) [Import Parity Price (IPP): IPP represents the price that importers would pay in case of actual import of Diesel at the respective Indian ports.]	Rs./Litre	46.36
9.	Export Parity Price [Export Parity Price (EPP): EPP represents the price which oil companies would realize on export of diesel <i>i.e.</i> FOB price of product (Serial No.1) plus Advance License benefit (ALB) (for duty free import of crude oil pursuant to export of refined products). Consequent to abolition of Customs Duty of Crude oil w.e.f. 25.06.2011, the ALB is currently Nil.]	Rs./Litre	44.06
10.	Trade Parity Price [80% of (8) + 20% of (9)] [Trade Parity Price (TPP): Trade Parity Price is 80% of IPP & 20% of EPP w.e.f. 16.6.2006 as per recommendations of Rangarajan Committee Report.]	Rs./Litre	45.90
11.	Refinery Transfer Price (RTP) for BS-III Diesel (Price Paid by the Oil Marketing Companies to Refineries) [Refinery Transfer Price (RTP): RTP based on Trade Parity Price is the price paid by the Oil Marketing Companies to domestic refineries for purchase of diesel at refinery gate.]	Rs./Litre	45.90

Sl. No.	Elements	Unit	w.e.f. 16th February 2013
12	Add: Premium recovered for BS-IV Grade over BS-III	Rs./Litre	0.04
13	Add : Inland Freight and Delivery Charges [Inland Freight & Delivery charges: It comprises of average freight from ports to inland locations and delivery charges up to Retail Outlet.]	Rs./Litre	0.85
14.	Add : Marketing Cost of OMCs [Marketing Cost: Marketing Cost & Margin is as per Marketing Cost Study Report, Nov. 2006 by Cost Accounts Branch, MoF.]	Rs./Litre	0.67
15.	Add : Marketing Margin of OMCs [Marketing Margin: Marketing Cost & Margin is as per Marketing Cost Study Report, Nov. 2006 by Cost Accounts Branch, MoF.]	Rs./Litre	0.71
16.	Total Desired Price (Sum of 11 to 15)—Before Excise Duty, VAT and Dealer Commission	Rs./Litre	48.17
17.	Less: Under-recovery to Oil Marketing Companies [Under recovery to OMCs: Difference between Desired Price and Actual selling price (excluding Excise Duty, VAT and dealer commission), represents under-recoveries to OMCs.]	Rs./Litre	10.27
18.	Price Charged to Dealers (Depot Price) (16-17)—Excluding Excise Duty & VAT [Excise Duty: Excise duty on diesel is Rs. 3.46/Litre + Education Cess @ 3%]	Rs./Litre	37.90
19.	Add : Specific Excise Duty @ Rs. 3.56/Litre (Rs. 3.46/Litre+ 3% Education Cess)	Rs./Litre	3.56
20	Add : Dealer Commission [Dealer Commission: Dealer commission on diesel is Rs. 912/KL (effective 01 July 2011) as fixed by MoP&NG]	Rs./Litre	1.09
21.	Add : VAT (including VAT on Dealer Commission) applicable for Delhi @ 12.50% and Air Ambience Charges @ Rs. 250/KL. [VAT (Sales Tax): VAT at applicable retail in respective State. It varies from State to State. Currently in Delhi, State Taxes on Diesel is VAT @ 12.50% + Air Ambience charges Rs. 250/KL]	Rs./Litre	5.60
22.	Retail Selling Price at Delhi (Sum of 18 to 21)	Rs./Litre	48.16

Subsequent to dismantling of APM in April 2002, since the prices of petroleum products were linked to international prices, the Public Sector Oil Marketing Companies (OMCs) carried out revision in prices of petroleum products in line with international prices. However, in view of the continuous increase in oil prices in international market since 2004 onwards, the Government started modulating the retail selling

prices of sensitive petroleum products, including diesel. Despite the increase in the international prices since 2004-05, the Retail Selling Prices (RSP) of these products, including diesel, were being maintained at lower levels in order to insulate the common man from the impact of rise in international oil prices and the domestic inflationary conditions.

The comparisons of the increase in prices of diesel in the international market *vis-à-vis* in India during 2002-2003 to 2011-2012 are given in Table-4:

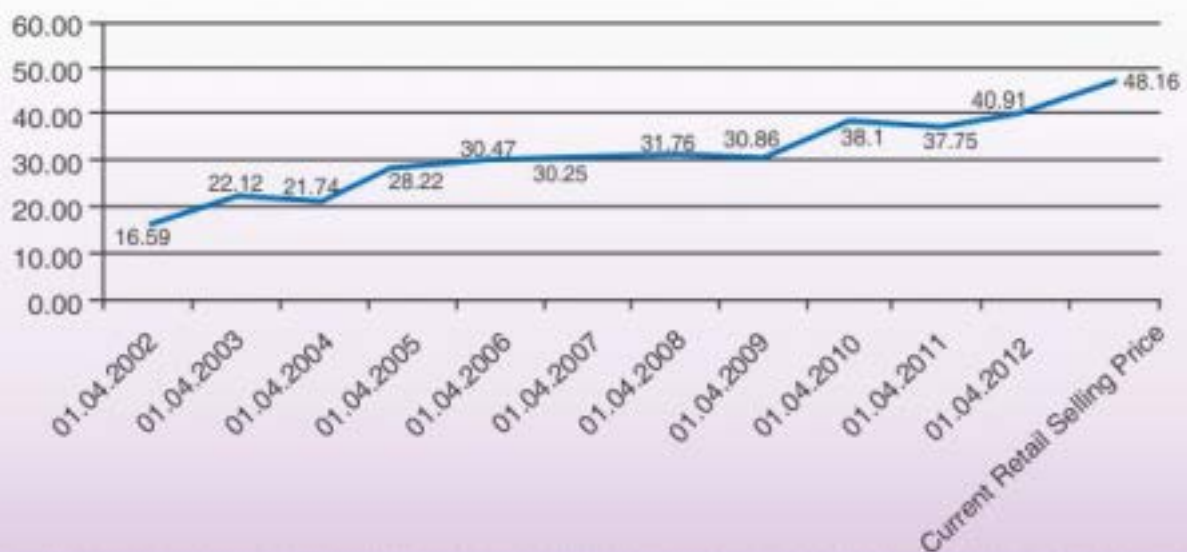
Table-4: Prices of Diesel in International and National (Delhi) Markets

Year/Period	\$/bbl.	Year/Period	Rs./Litre
Mar.-2002	23.27	01.04.02	16.59
2002-03	28.86	01.04.03	22.12
2003-04	30.39	01.04.04	21.74
2004-05	46.91	01.04.05	28.22
2005-06	64.70	01.04.06	30.47
2006-07	74.12	01.04.07	30.25
2007-08	92.91	01.04.08	31.76
2008-09	101.75	01.04.09	30.86
2009-10	74.67	01.04.10	38.10
2010-11	95.66	01.04.11	37.75
2011-12	125.38	01.04.12	40.91
2012-13 (up to 15.1.2013)	121.22	Current RSP	48.16

Graph-7: Prices of Diesel in International Market (\$/bbl.)



Graph-8: Prices of Diesel in Delhi, India (Rs./Litre)



A study of the above figures reveals that there has been an increase of 299 per cent in the international prices of diesel in 2012-13 over the prices of diesel in 2003-04. Similarly, at the national level, there has been an increase of 121 per cent in the retail selling price of diesel in 2012-13 over the retail price of diesel as obtained on 01 April 2004.

SUBSIDY ON DIESEL PRICES AND UNDER-RECOVERIES

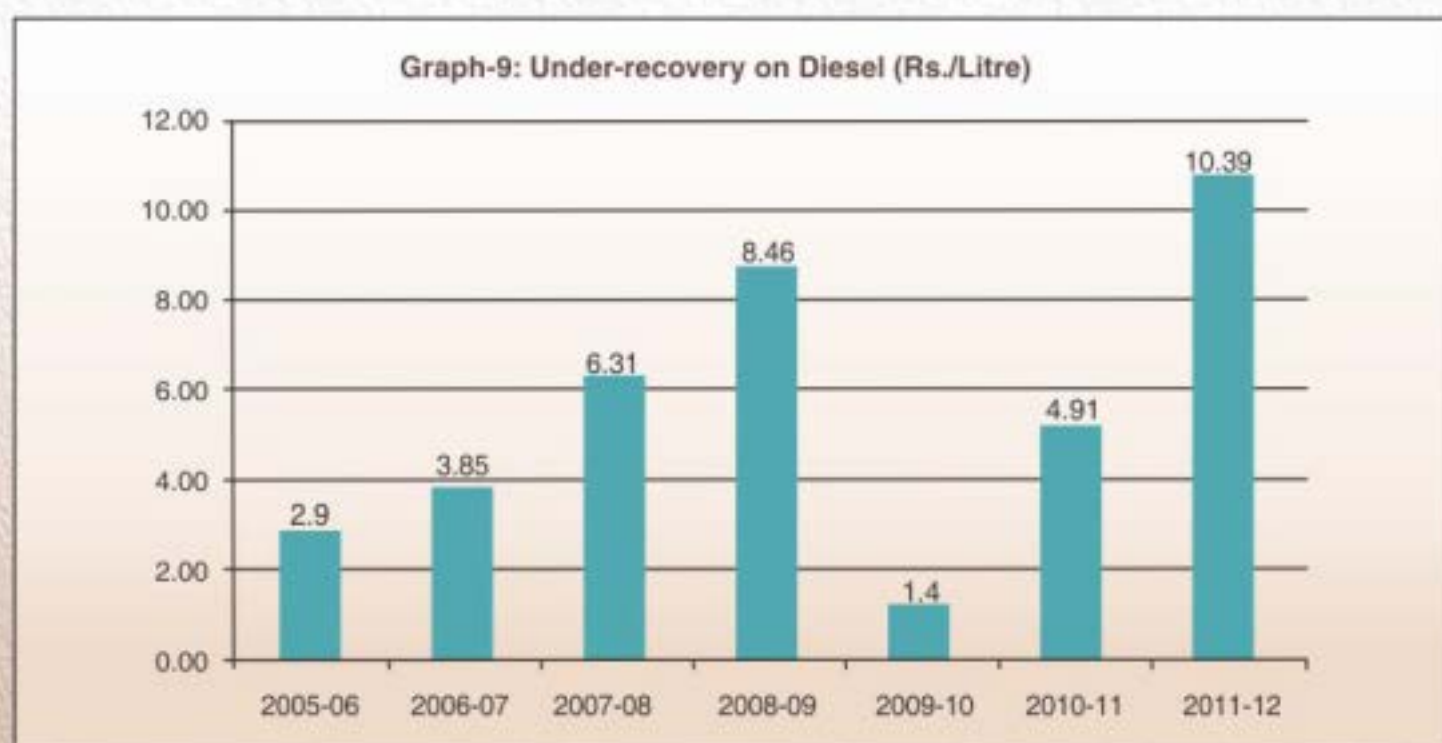
Subsidies are one of the most powerful policy tools in the hands of the Government. They have been used for decades to achieve a range of economic, social and environmental objectives. India has been subsidizing energy with the objective of protecting its consumers from

international price volatility and providing energy access to the citizens, especially the poor. However, energy subsidies place a heavy burden on the Government budgets. While subsidies on petroleum products are provided in the form of lower prices for the final products, cash assistance is provided by the Government as partial compensation for the total under-recoveries incurred by the Public Sector Oil Marketing Companies (OMCs).

As the retail selling prices of sensitive petroleum products were regulated by the Government, the Public Sector Oil Marketing Companies (OMCs) incurred under-recoveries on sale of diesel and such other regulated products. The details of per unit and total under-recoveries incurred by the OMCs on account of the sale of diesel since 2005-06 are given in Table-5 and 6.

Table-5: Under-Recovery incurred by the OMCs on account of sale of Diesel since 2005-06

Year	Under-recovery on Diesel		Under-recovery on all regulated products Rs. crore
	Rs./Litre	Total (Rs. crore)	
2005-06	2.9	12,647	40,000
2006-07	3.85	18,776	49,387
2007-08	6.31	35,166	77,123
2008-09	8.46	52,286	103,292
2009-10	1.4	9,279	46,051
2010-11	4.91	34,706	78,190
2011-12	10.39	81,192	138,541



Graph-10: Under-Recovery on Diesel (Rs. in Crore)

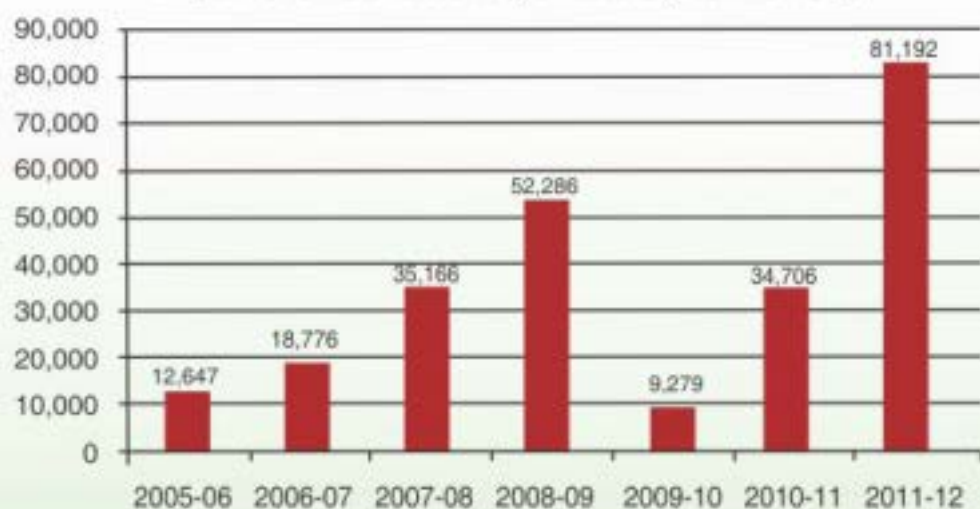
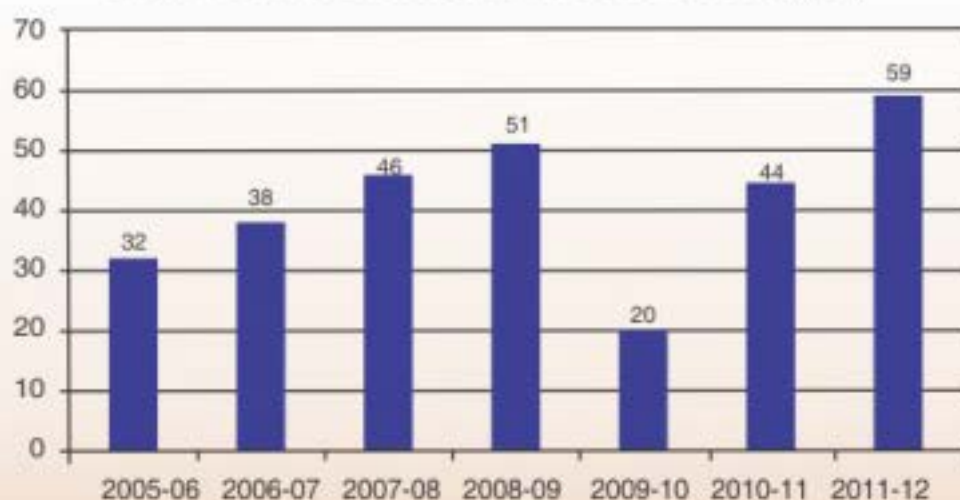


Table-6: Share of Diesel in total Under-Recovery since 2005-06

Year	Share of Diesel in total Under-recovery (%)
2005-06	32
2006-07	38
2007-08	46
2008-09	51
2009-10	20
2010-11	44
2011-12	59

Graph-11: Share of Diesel in total Under-Recovery (%)



The under-recoveries incurred by the Public Sector OMCs on sensitive products like diesel are being compensated by the Government (through oil bonds and cash assistance to OMCs) and by the upstream oil companies engaged in exploration and production (through discount on crude and products) under the burden sharing mechanism.

In view of the continuing high under-recoveries on diesel, PDS Kerosene and domestic LPG and non-receipt of requisite budgetary support on time, the Public Sector OMCs have been resorting to huge market borrowings to meet their working capital requirements. The combined borrowing of the OMCs increased to a whopping figure of

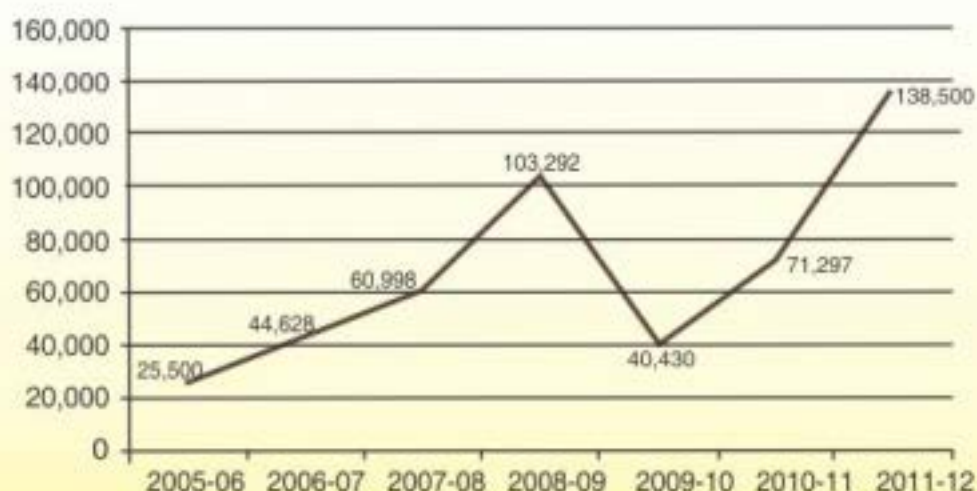
around Rs.1,69,000 crore as on 31 December 2012. Majority of these borrowings are reported to be for meeting their working capital requirements. During the year 2011-12, the OMCs reported a combined Profit After Tax (PAT) of mere Rs. 6,177 crore which was only 0.7% of their combined turnover of Rs. 8,22,828 crore. The Public Sector OMCs were able to report profits only as a result of getting significant compensation of their under-recoveries from the Government and the public sector upstream oil companies. Without the assistance from the Government and upstream companies, the OMCs would not have been in a position to maintain supplies of petroleum products in the country and would have reported huge losses as given below:

Table 7: Loss of OMCs without Government Assistance and Upstream Discount

(Rs. in Crore)

	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Combined Profit After Tax (PAT) of OMCs	5,625	10,876	9,679	4,261	13,060	10,531	6,177
Provision for Taxation	1,805	4,344	4,107	1,784	5,537	3,323	680
Profit before Tax	7,430	15,220	13,786	6,045	18,597	13,855	6,857
Less : Compensation Received							
Oil Bonds/Budgetary Support	11,500	24,121	35,290	71,292	26,000	41,000	83,500
Upstream assistance	14,000	20,507	25,708	32,000	14,430	30,297	55,000
Total Compensation	25,500	44,628	60,998	103,292	40,430	71,297	1,38,500
Loss of OMCs without Compensation	-18,070	-29,408	-47,212	-97,247	-21,833	-57,442	-1,31,643

Graph-12: Total Compensation to OMCs (Rs. in Crore)



RECENT DECISION OF THE GOVERNMENT ON DIESEL PRICES

Pursuant to the decision of the Cabinet Committee on Political Affairs (CCPA) in its meeting held on 17 January 2013, the Public Sector OMCs have been authorized to— (a) increase the retail selling price of diesel in the range of 40 paise to 50 paise per litre per month (excluding VAT as applicable in different States/Union Territories) to reduce the diesel subsidy gradually; and (b) sell diesel to all consumers taking bulk supplies directly from the installations of the OMCs at the non-subsidized market determined price with immediate effect. The OMCs, however, will not be eligible for any subsidy on such direct sale of diesel to bulk consumers.

CONCLUSION

It has been observed in different quarters that abolishing price controls and dismantling subsidy programmes would lead to an improvement in the Government's finances. It would also free up public funds which could then be used for other development-related expenditures. A reform of prices will also have an overall positive impact on the oil sector. It will reduce the borrowing and interest expenditure of the refining and marketing companies and, at the same time, will increase funds available for upstream companies to invest in exploration and production activities. Also, the downstream companies

will be encouraged to invest in producing better and cleaner grades of automotive fuels. Market-based pricing of fuels will also facilitate and encourage private players to enter the retail market for petroleum products, which, in turn, will lead to a more competitive market. Efficient pricing of fuels will also create a competitive market between different types of fuel and may even encourage a shift towards cleaner and more efficient forms of energy.

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