Explained: How fuel price decontrol works — or why consumers always lose out

India fuel prices: The key beneficiary in this subversion of price decontrol is the government. The consumer is a clear loser, alongside fuel retailing companies as well.

Written by **Anil Sasi** , Edited by Explained Desk | New Delhi | Updated: June 16, 2020 10:55:47 am

A worker fills a vehicle with diesel at a fuel station in Ahmedabad. (Reuters Photo(

In theory, retail prices of petrol and diesel in India are linked to the global crude prices. There is supposed to be complete decontrol of consumer-end prices of auto fuels and others such as the aviation turbine fuel or ATF. Which means that if crude prices fall, as has largely been the trend since February, retails prices should come down too, and vice versa.

Has that been happening?

No. Since June 7, when the revisions began after a 82-day hiatus, petrol is up Rs 4.98 and diesel is up by Rs 5.23. This is the highest levels in about 21 months, despite crude sill under $39 a barrel (Brent). This coincided with oil benchmarks heading for their first weekly declines, with Brent and US crude index (WTI) dropping about 10 per cent, breaking a rally that pushed oil off its April low as the marke reconciled with the reality that Covid-19 may be far from over.

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So, why the divergence in the trends?

One main reason: Oil price decontrol is a one-way street in India — when global prices go up, this is passed on to the consumer, who has to cough up more for every litre of fuel consumed. But when the reverse happens and prices go down, the government — almost by default — slaps fresh taxes and levies to ensure that it rakes in extra revenues, even as the consumer, who should have ideally benefited by way of lower pump prices, is short changed and forced to either pay what she's already paying, or even more. The key beneficiary in this subversion of price decontrol is the government. The consumer is a clear loser, alongside fuel retailing companies as well.

How does decontrol work?

Price decontrol essentially offers fuel retailers such as Indian Oil, HPCL or BPCL the freedom to fix prices of petrol or diesel based on calculations of their own cost and profits — essentially a factor of the price at which the source their inputs from upstream oil companies such as ONGC Ltd or OIL India Ltd, for whom the price benchmark is derived from global crude prices. Fuel price decontrol has been a step-by-step exercise, with the government freeing up prices of ATF in 2002, petrol in the year 2010 and diesel in October 2014. Prior to that, the Government used to intervene in fixing the price at which the fuel retailers used to sell diesel or petrol. While fuels such as domestic LPG and kerosene still are under price control, for other fuels such as petrol, diesel or ATF, the price is supposed to be reflective of the price movements of the so-called Indian basket of crude oil (which represents a derived basket comprising a variety — 'sour grade' (Oman and Dubai ave 'sweet grade' (Brent) — of crude oil processed in Indian refineries).

Why haven't consumers benefited now despite the sharp fall in crude prices since February?

Crude prices nosedived from an average of about \$55 per barrel in February to \$35 in early March, and then falling to \$20 by end March as demand slumped because of the pandemic. From that point, the prices have recovered to around \$37 now. On the other hand, in India, retail prices of fuel were frozen for a record 82-days that covered much of this period, even as the excise duty on fuels was hiked by the Centre twice. While the government claimed that the impact of the hike was not passed on to consumers, the latter, however, did not benefit from this fall in crude oil prices to record low levels. Apart from the Centre, a number of states too hiked the levies on auto fuels during this period.

The decision to raise the duties, Finance Ministry officials said, was taken in view of the tight fiscal situation and that retail prices were unchanged. So, effectively, the excise duty hikes by the centre was to be adjusted by the OMCs against the fall in oil prices. But now, the retail prices are being progressively hiked.

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Are India's taxes on fuels high?

On May 5, the Centre announced one of the steepest ever hikes in excise duty by Rs 13 per litre on diesel and Rs 10 per litre on petrol, following up on another round of sharp hikes in the first week of March. All of this effectively cements India's position as the country with among the highest taxes on fuel. Prior to the increase in excise duty (in February 2020), the government, centre plus states was collecting around 107 per cent taxes, (Excise Duty and VAT) on the base price of pet per cent in the case of diesel. Post the first revision the government was a collect around 134 per cent taxes, (Excise Duty and VAT) on the base pric and 88 per cent in the case of diesel (as on March 16, 2020). With the second revision in excise duty in May, the government is collecting around 260 per cent taxes, (Excise Duty and VAT) on the base price of petrol and 256 per cent in the case of diesel (as on 6th May 2020), according to estimates by CARE Ratings.

In comparison, taxes on fuels as a percentage of pump prices was around 65 per cent of the retail price in Germany and Italy, 62 per cent in the UK, 45 per cent in Japan and under 20 per cent in the US.

Now, as countries get their economies back on track, oil prices have been moving upwards from the lows seen in April. So, as OMCs pass these hikes on, consumers are forced to bear the increase in global crude prices and face up to the harsh reality — that every time the crude price drops sharply, the government uses the opportunity to fill up its coffers while pump prices for the consumer barely change. But when the reverse happens, consumers are forced to pay up more. So the government gets to encash the upside while the consumers have to make good the downside.

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Do OMCs also benefit?

The only entity that benefits at the consumers expense is the government — in fact, both the Central and state governments. OMCs, interestingly, are also among the losers from the sharp downward gyrations in oil prices. The problem for companies such as IOC or BPCL is that a continuous slide in fuel prices leads to the prospect of inventory losses — a technical term for the losses incurred when crude oil prices start falling and companies that have sourced the crude oil at higher prices discover that the prices have tumbled by the time the product reaches the refinery for processing or the finished product is ready for selling. Including both crude oil and products, companies such as IOC keep an inventory of about 20-50 days.

For oil refiners, the inventory loss was pegged at over Rs 25,000 crore in the January-March quarter because of the 70 per cent fall in crude oil prices, and a likely plunge in their gross refining margins in the first quarter (April-Ju 2021 because of demand destruction, according to CRISIL estimates.

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Did other fuels see an impact?

Interestingly, prices of ATF was cut seven consecutive times since February. Prior to the beginning of the reduction cycle in February — when airlines had already started curtailing flights on account of low demand and travel restrictions caused by COVID-19 outbreak — the price of jet fuel stood at Rs 64,323.76 per kilolitre.

Even as no airline operated scheduled passenger flights, the mainstay of their business, between March 25 and May 25, oil companies continued to pass on the reduction in crude oil rates in the form of cutting the price for jet fuel. Starting from May 25, the Centre allowed airlines to operate commercial passenger flights on domestic routes, hitherto with a curtailed schedule.

Six days after the resumption of flights, the Centre announced a sharp 56 per cent increase in ATF prices, effectively negating any tangible benefits to airlines.