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Impact Analysis: Rangarajan Committee Recommendations

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The Rangarajan Committee's recommendations have tried addressing the concerns of the oil industry. If the recommendations are implemented in totality, it would benefit the oil industry.

However, the committee has failed to provide a long-term solution for issues relating to pricing and taxation of petroleum products. Also, the government would find it difficult to implement some of its recommendations.

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Petro products: Pricing and Taxation

Impact of the Rangarajan Committee recommendations (If implemented)

The Rangarajan Committee, set up to advise on petroleum product pricing, submitted its proposal to the Petroleum Ministry on February 17, 2006.

CRIS INFAC has tried to analyse the potential impact of all the recommendations proposed by the Committee, if implemented in totality. While the committee has tried to address the concerns of the oil marketing companies (OMCs) to some extent, it fails to correct the structural anomalies that exist in the pricing and taxation of petroleum products.

The Committee's recommendations with respect to petrol and diesel (except for their price revision), if accepted and implemented, would only lead to a shift in profits from the refining side of the industry to the marketing side (assuming the retail prices of these products remain unchanged), leaving the overall industry in the same financial position as before. However, any domestic retail price increase in these products would increase the profitability of the industry.

The Committee has not come up with a long-term solution for issues relating to pricing of petroleum products. The measures such as shifting to specific duties and raising contribution from upstream oil companies through higher cess seem to be based on the present high petroleum product price scenario; however, if there is a drop in these prices, then these issues would need to be adjusted to the prevailing conditions.

Also, suggestions on hiking LPG price and targeted kerosene subsidies might be difficult to implement.

Background

The prices of crude oil and petroleum products (especially petrol, diesel, kerosene and liquefied petroleum gas) reached record levels in the international market in 2005-06. But, with the government unwilling to increase the domestic retail prices of these products, the profitability of oil marketing companies (OMCs) viz., Indian Oil Corporation (IOC), Bharat Petroleum Corporation Limited (BPCL), Hindustan Petroleum Corporation Limited (HPCL) and the standalone marketing company IBP was impacted, with BPCL, HPCL and IBP registering operating losses for the 9 months ended December 2005. To address the concerns of the oil companies and to have a more long-term solution in place, the government set up the Rangarajan Committee under Dr C Rangarajan, Chairman, Economic Advisory Council (EAC) to the Prime Minister.

Recommendations of the Rangarajan Committee

- Adopting the trade parity principle for pricing of petrol and diesel, based on a weighted average of the import parity and the export parity prices in the ratio of 80:20. This principle of trade parity pricing will apply for the refinery gate price as well as for determining the retail price.
 - Currently, the pricing of petrol and diesel is based on the import parity principle.
- Terminating the principle of freight equalisation for calculating the price of petrol and diesel at different locations.
 - Currently, a common freight charge is used to calculate the price of petrol and diesel for all locations in India.
- The government should keep themselves at arms length from the actual price setting of petrol and diesel, and allow the oil marketing companies the flexibility to fix the actual retail price subject to the indicative trade parity price ceiling.
 - At present, the government controls the prices of petrol and diesel in an effort to protect the consumers from the high price volatility of these products in the international market.
- Reduce the customs duty on petrol and diesel to 7.5 per cent.
 - Currently, the customs duties on these products are at 10 per cent.
- The Committee has mentioned that an upward adjustment in the prices of petrol and diesel to the extent of Rs 0.31/litre and Rs 1.2/litre (Mumbai retail prices), respectively, is warranted if its recommendations are accepted. Else the price increase required would be Rs 0.51/litre on petrol and Rs 2.68/litre on diesel (Mumbai prices). It has further stated that if the government were to decide not to increase the prices of these products, then it should bear the burden caused by their increasing international prices.
 - At present, the retail price of petrol in Mumbai is Rs 49.16/litre, and diesel is Rs 35.57/litre.
- Excise levies on petrol and diesel to be made specific.
 - Currently, excise levy on petrol and diesel is a combination of ad-valorem and specific rates. (The excise duty on petrol is 8 per cent + Rs 13/litre while the excise duty on diesel is 8 per cent + Rs 3.25/litre. In addition, there is an education cess to be paid.)
- Subsidised kerosene to be restricted to below poverty line (BPL) families.
 - Currently, kerosene is sold at subsidised rates to all consumers regardless of their economic status.
- Adjust the price of domestic LPG by Rs 75/cylinder and then progressively increase it further in line with the international price.
 - At present, the retail selling price of LPG in Mumbai is Rs 297.95/cylinder

- Government to determine the quantum of subsidy to be borne by upstream companies (ONGC/ OIL) up-front and collect it by suitably adjusting the rate of cess.
 - At present, the upstream companies explicitly contribute to their share of subsidy under-recovery on LPG and kerosene to the oil marketing companies.

Implications

Summary of impact - After Committee recommendations are accepted on MS and HSD

Rs/billion	Increase in MS and HSD prices after accepting the committees' recommendations	Revision of domestic LPG prices by Rs/75 per cylinder	Restricting subsidised kerosene to BPL	Increase in cess in place of subsidy sharing	Total gain/(loss)
Government			4.60		4.60
Upstream companies		12.46	22.21	39.51	74.19
Refining and Marketing industry	50.23	24.93	44.42		119.59
Overall impact	50.23	37.39	71.24	39.51	198.38

Note

1) The impact does not take into account the stock changes.

Source: CRIS INFAC

Summary of impact - Without accepting the Committee recommendations on MS and HSD

Rs/billion	Increase in MS and HSD prices without accepting the committees' recommendations	Revision of domestic LPG prices by Rs/75 per cylinder	Restricting subsidised kerosene to BPL	Increase in cess in place of subsidy sharing	Total gain/(loss)
Government			4.60		4.60
Upstream companies		12.46	22.21	39.51	74.19
Refining and Marketing industry	110.30	24.93	44.42		179.66
Overall impact	110.30	37.39	71.24	39.51	258.45

Note

1) The impact does not take into account the stock changes.

Source: CRIS INFAC

New methodology for pricing petrol and diesel

The weighted average of import parity and export parity prices in the ratio of 80:20 would lower the refining profits of the industry as their realisations on these products would decline vis-à-vis their realisations under the import parity regime. We estimate an overall decline of Rs 36 billion in the refining profits of the industry. However, it needs to be mentioned that the marketing companies stand to benefit from the lower realisation of the refiners as their input costs on the same would decline to a similar extent, resulting in higher marketing profits. Thus, the industry as a whole is expected to be in a no gain - no loss position.

Reduction of customs duty on petrol and diesel

The reduction of import duty on petrol and diesel from the existing 10 per cent to 7.5 per cent would further lower the duty protection enjoyed by the refiners. We estimate that this would in effect lower the refining profits of the industry by Rs 32 billion. Conversely, marketing companies would be able to earn higher profits to a similar extent as they would be able to source these products at a lower price leaving no impact on the overall industry profitability.

Impact on refining and marketing profits

(Rs billion)	Shift from import parity pricing To trade parity pricing	Reduction in import duty From 10 per cent to 7.5 per cent	Combined Impact
Refining profits	(35.96)	(32.32)	(61.82)
Marketing profits	35.96	32.32	61.82
Overall impact	0.00	0.00	0.00

Notes

- 1) The impact of stock changes is not considered.
- 2) The impacts does not include the impact of removal of frieght equalisation

Source: CRIS INFAC

Termination of the principle of freight equalisation

The shift from a common freight principle of calculating the price of petrol and diesel to a location-specific freight would have mixed implications for refiners. The move would have a positive impact on the refiners that are placed in the interiors and a negative impact on the refiners that are based on the coasts. However, the benefits or costs assumed by the refiners would be offset by the costs incurred or benefits realised by the marketing companies, leaving the overall industry at neutral.

Freight impact

	Positive Based in the interiors	Negative Based in the coastal
Companies		
IOC	Digboi Guwahati Barauni Koyali Mathura Panipat	Haldia
BRPL	Bongaigaon	
CPCL		Narimanam Manali
BPCL		Mumbai
KRL		Cochin
NRL	Numaligarh	
HPCL		Mumbai Vizag
MRPL		Mangalore
RIL		Jamnagar
ONGC		Tatipaka

Source: CRIS INFAC

Increase in price of MS and HSD

If the government were to increase the price of petrol and diesel, after adhering to the recommendations of the Committee with regard to the pricing of these products, then the marketing profits of the industry would offset the losses suffered by the refiners, which would see an overall gain for the industry. We estimate that the overall industry would gain to the extent of Rs 50 billion.

If however, the Committee is of the opinion that the recommendations of the Committee with regard to the pricing of petrol and diesel are not acceptable, but accepts the increase in the prices of these products warranted by the Committee, then the industry stands to gain to the extent of marketing profits, expected to be Rs 110 billion.

Impact of increase in MS and HSD prices

(Rs/billion)	Increase in MS and HSD prices after accepting the committees' recommendations	Increase in MS and HSD prices without accepting the committees' recommendations
	Refining profits	-61.82
Marketing profits	112.05	110.30
Overall impact	50.23	110.30
As per recommendations		
Increase in price (Mumbai price - (Rs/litre))		
MS	0.31	
HSD	1.2	
Without recommendations		
MS	0.51	
HSD	2.68	

Source: Committee report and CRIS INFAC

Upward revision of LPG prices

An increase of Rs 75/cylinder (in the domestic retail price of LPG) would reduce the subsidy under-recovery position on this fuel, which in turn would benefit the overall industry. We estimate that the oil industry stands to gain to the extent of Rs 37 billion from this price revision

Revision of domestic LPG prices by Rs/75 per cylinder

(Rs billion)	Under-recovery		Total gain/(loss)
	Pre - revision	Post - revision	
Upstream companies	(26.82)	(14.36)	12.46
OMCs	(53.65)	(28.72)	24.93
Overall impact	(80.47)	(43.08)	37.39

Note

1) Figures exclude governments share of subsidy

Source: CRIS INFAC

Change in excise levy

from ad-valorem and specific to only specific – The Committee has recommended that the excise levy pertaining to petrol and diesel, which at present is a combination of ad-valorem duty and specific duty be made completely specific at the prevailing excise duty per unit of these products. Although this would shield the consumers in a high price (of crude oil)

scenario since excise duty incidence on the final retail price would be lower, in a situation of declining crude prices, the incidence would be higher.

Indian basket (\$/bbl)	2005-06	Prices of crude			
	54.71	30.00	40.00	50.00	60.00
Excise duty as a percent of final retail price					
MS					
Ad valorem + specific	30.52	36.96	33.99	31.53	29.47
Specific	30.52	37.73	34.44	31.67	29.32
HSD					
Ad valorem + specific	13.55	16.61	15.13	14.00	13.11
Specific	13.55	18.26	16.01	14.25	12.85

Source: CRIS INFAC

Kerosene at subsidised rates to below poverty line (BPL) families

If the recommendation can be successfully implemented, the subsidy provided by the government on this product would decline, and so will the huge subsidy under-recovery borne by the oil industry. However, the fact that at present there is no suitable operational mechanism that would support the implementation of this scheme, leaves a big question mark over the success of the same. If successfully implemented, we expect the gain to the oil industry to amount to Rs 66 billion.

Impact due to restricted subsidy on SKO to BPL

(Rs billion)	Subsidised	Restricting subsidised	Total
Government (Subsidy)	(7.67)	(3.07)	4.60
Upstream companies (Subsidy under-recovery)	(37.02)	(14.81)	22.21
OMCs (Subsidy under-recovery)	(74.04)	(29.62)	44.42
Overall impact	(118.73)	(47.49)	71.24

Note

1) BPL families account for 40 per cent of the total

Source: CRIS INFAC

MS and HSD prices to be fixed without government intervention

The Committee has also recommended that the government keep themselves away from the actual retail price setting of petrol and diesel subject to the indicative trade parity price ceiling. Though this would be a positive development for the OMCs, in case of a further increase in the international prices of these products, it would be difficult for the government not to interject in setting the final retail price of these products.

Increase in cess in place of subsidy sharing

The Committee has proposed to discontinue the practice of asking the upstream companies (ONGC/OIL) to provide direct assistance to the OMCs in subsidy sharing on LPG and kerosene. Instead, they have recommended that the government determine the quantum of subsidy to be borne by upstream companies and collect the same by increasing the rate of cess. Again, this would have a positive impact on the upstream companies in a high price scenario as the outflow in terms of subsidy would be capped at a certain amount, but when the prices do fall, this would entail a higher burden than otherwise. Also, since the entire

amount collected would go to the government's kitty, the utilisation of these funds for the said purposes may not always materialise.

Impact on ONGC/OIL

Rs billion	Present	Proposed	Total gain/(loss)
OIDB cess	54.29	144.78	-90.49
Upstream companies contribution to subsidy	130.00	0.00	130.00
Overall impact	184.29	144.78	39.51

Notes

- 1) The figures are on the basis of production estimates of 2005-06 for ONGC/OIL
- 2) Upstream subsidy sharing amount is as per the Rangarajan committee report

Source: CRIS INFAC

Impact on companies

If the recommendations of the Committee were to be accepted by the government in totality, the standalone refiners are expected to take a hit of Rs 20 billion mainly on account of the reduction in their duty protection. On the other hand, the refining and marketing companies are expected to gain to the extent of Rs 125 billion. The gain could be attributed to their increase in marketing profits and savings on the sharing of subsidy under-recovery on LPG and SKO. Standalone marketing companies too are expected to register profits to the tune of Rs 14 billion due to the changes recommended in the pricing of MS and HSD combined with an increase in prices of these products.

Net impact on companies - After Committee recommendations are accepted on MS and HSD

(Rs billion)	Combined impact due to change in import duty and shift from import parity to trade parity	Increase in MS and HSD prices after accepting the committees' recommendations	Revision of domestic LPG prices by Rs/75 per cylinder	Restricting subsidised kerosene to BPL families	Overall impact
Standalone refiners					
BRPL	(1.59)	(1.59)			(1.59)
CPCL	(4.86)	(4.86)			(4.86)
KRL	(4.90)	(4.90)			(4.90)
NRL	(1.57)	(1.50)			(1.50)
MRPL	(7.20)	(6.92)			(6.92)
					(19.77)
OMC					
IOC	(2.07)	15.74	11.80	26.20	53.74
BPCL	10.07	22.44	6.62	7.42	36.48
HPCL	6.41	17.31	6.41	8.46	32.18
RIL	(0.59)	3.01			3.01
					125.42
Marketing companies					
IBP	5.92	10.80	0.10	2.34	13.24
Essar	0.35	0.63			0.63
Shell	0.03	0.05			0.05
					13.93
Overall impact	0.00	50.22	24.93	44.42	119.58

Notes

- 1) Combined impact due to change in import duty and shift from import parity to trade parity, Excludes the impact of freight equalisation, since it would be different for different refineries
- 2) The impact does not take into account the stock changes.

Source: CRIS INFAC

However, if the government were to repudiate the recommendations of the Committee with regard to the pricing of MS and HSD, but agree to the hike warranted by it on these products, then the marketing profits earned on these auto fuels would see the industry's profits increase by Rs 110 billion. Combined with the benefits of the price increase in LPG and the restriction on the kerosene subsidy to BPL families, the overall industry is expected to gain Rs 180 billion.

Net impact on companies - Without accepting the Committee recommendations on MS and HSD

(Rs billion)	Increase in MS and HSD prices without accepting the committees' recommendations	Revision of domestic LPG prices by Rs/75 per cylinder	Restricting subsidised kerosene to BPL families	Overall Impact
Standalone refiners				
BRPL	0.00			0.00
CPCL	0.00			0.00
KRL	0.00			0.00
NRL	0.16			0.16
MRPL	0.63			0.63
				0.79
OMC				
IOC	39.12	11.80	26.20	77.12
BPCL	27.10	6.62	7.42	41.14
HPCL	23.88	6.41	8.46	38.76
RIL	7.98			7.98
				165.00
Marketing companies				
IBP	10.74	0.10	2.34	13.18
Essar	0.63			0.63
Shell	0.04			0.04
				13.86
Overall impact	110.30	24.93	44.42	179.65

Note

1) The impact does not take into account the stock changes.

Source: CRIS INFAC

In conclusion, the Rangarajan Committee has tried to address most of the concerns of the oil industry (especially issues relating to the pricing and taxation of petroleum products). However, it remains to be seen how many proposals recommended by the Committee are actually accepted by the government. Moreover, the implementation of these proposals might to prove to be a more difficult proposition.