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July 1996: Oil shock

The government's siphoning of funds from the oil account triggered the price hike this month, alleges Uttam Gupta

THE JULY increase in the prices of petroleum products by 15-30 per cent is a blow to the poor. Prices of essentials like foodgrains, cooking fuel, vegetables and transport will go up, as will LPG prices. The LPG hike from Rs 94-110 to Rs 120-125 per cylinder will force many of them to shift to cheaper fuels like kerosene.

Although, the price of kerosene has been kept constant, its supply to the poor at subsidised rates will be affected due to the steep increase in the prices of LPG, diesel and petrol. This is because the increased price differential would lead to largescale diversion of the former for direct sales to consumers at a higher price and also to mix with diesel or petrol for transport.

Road transport charges have already gone up leading to an increase in the cost of travel, education (through increases in school transport fee), and food. Though the Railway freight for essential commodities has not been touched, that is little relief as bulk of the movement is either by road or rail-cum-road.

Consumers buy food from the PDS or the market. In the market, the situation has already turned from bad to worse. In Delhi for instance, the hapless consumer is now paying Rs 8 per kg for wheat flour, against Rs 7.4 before the hike. Likewise, the price of rice has gone up sharply due to an increase in the processing cost of paddy and transport cost. The issue price on sale from the ration shop too will increase soon, as the government will try to hold the food subsidy down.

Shortly after the POL hike, the government increased the concession on decontrolled phosphatic (P) and potassic (K) fertilisers. This was to offset the higher cost of production or import through increases in world raw material and intermediate prices and rupee depreciation.

Despite the subsidy of Rs 3,000 per tonne on DAP, farmers now have to pay about Rs 8,400 per tonne, about 80 per cent higher than what they were paying four years ago. Farmers will have to pay more if the rupee falls further or world prices firm up.

Prices of naphtha, fuel oil and LSHS, basic fuel used for fertilisers have been increased by 30 per cent each. This will raise the cost of urea by about Rs 800 per tonne for naphtha-based and about Rs 650 per tonne for fuel oil-based plants.

All gas-based units are using these liquid fuels to run captive power and steam generation facilities. Their cost of production will increase. Since 0.1 tonne of naphtha supplies 1 million Kcal energy to make one tonne urea, the production cost in these plants will increase by about Rs 135 per tonne.

The cost of phosphatic fertilisers will also increase: DAP by Rs 300 per tonne for units sourcing ammonia from captive plants based on naphtha. Increase in transport cost will further add to the user cost.

For decontrolled P & K fertilisers, the increase in the cost of production and transport will result in a corresponding increase in the selling price. For urea, the price of which is controlled, the government can either increase the price or increase the subsidy burden. At present, it favours the latter. However, the former cannot be postponed because of the mounting subsidy pressure.

In the past, the government has protected its staff and central PSUs from inflation by enhancing DA. With inflation likely to increase, another hike in DA may be in the offing. The common man will be hit by inflation triggered by sops to government employees.

The government has justified the increase in POL prices in terms of the need to plug the deficit in the Oil Pool Account (OPA) of Rs 5,700 crore. There is no transparency about the working of the OPA. Some probing may unravel the mystery. Petroleum companies are required to sell POL products at prices notified by the government, which fixes retention margins (RM) after covering all costs.

If the net realisation (NR) from selling POL at notified prices exceeds the RM, the company would have a surplus which is credited to the OPA. If the NR falls short of RM, the OPA pays the difference to the company.

The bulk of crude supplies are from domestic sources on which the government allows a fixed price to producers like the ONGC and OIL. Sometime back, this was raised from the equivalent of $4 per barrel to $7 per barrel (Rs 1,740 per tonne), even though the actual cost of production was significantly lower. This increases the payment liabilities of refineries, the corresponding increase in the surpluses of ONGC or OIL cannot be wished away.

The price of imported crude and POL products declined sharply up to 1994-95. The price allowed on domestic crude too, remained unchanged at $4 per barrel for most of the period. Despite hefty increases in the selling prices of POL products on three occasions, in July 1991, September 1992 and February 1994, a staggering deficit of Rs 3,800 crore at the end of 1994-95 is baffling.

A further increase in the deficit to Rs 5,700 crore at the end of 1995-96 may, however, be explicable in terms of the rupee depreciation since August 1995, and a small increase in the price of imported crude. Even this increase could have been contained through proper management and timing of imports. Clearly, there is much more to the deficit than what meets the common eye.

The question of cost overruns in implementing new projects requires attention. Sometime back, the parliamentary committee on petroleum had referred to huge time and cost overrun in the Kandla-Bhatinda oil pipeline and Neelam oil/gas fields. Are these being included in the RM allowed to the refineries?

Assume for a moment, that the present deficit was unavoidable. There are other stark facts we have to consider. At the end of 80s, the OPA had an accumulated 'surplus' of about Rs 9,000 crore. This was then appropriated by the government to reduce its budgetary deficit. Had it remained with the OPA, even after fully meeting the shortfalls pertaining to 1995-96, there would still be a huge surplus and hence, no need to increase the POL prices.

Additionally, the government makes heavy collections from the oil sector by way of cess on domestic crude at the rate of Rs 900 per tonne, and a host of duties, both custom and excise. Through the cess alone since 1974 it garnered a whopping amount of Rs 20,000 crore up to March last year. All these are paid for by consumers.

The present deficit in the OPA is not because the prices charged to consumers are inadequate, but mainly due to the siphoning of funds by the government to meet its ballooning consumption expenditure on the one hand, and its mismanagement on the other. The lack of transparency and accountability in the administration of the OPA makes matters worse.

The recent increase in POL prices should be rolled back, and the deficit in the OPA should be met from the government's budgetary support. This will only be fair and equitable as, in the past, it has drawn the surplus in the OPA and it has been collecting huge sums by way of taxes and duties from the oil sector.

For the future, the government should refrain from using the OPA for meeting its budgetary needs.

Considering that the OPA has a direct impact on the fate of the common or poor Indian, and on the overall health of the economy, its proper and effective management is of paramount importance.

Instead of the oil coordination committee (OCC) which is a part of the administrative setup in the ministry of petroleum and natural gas, this task should be entrusted to an autonomous high powered commission.

The commission should monitor and oversee the working of OPA based on clearly laid down guidelines in regard to norms for fixation of RM, the methodology of computations, modalities for use of funds and so on. Representatives of user industries and important consumer associations should be associated with the exercises to ensure transparency.