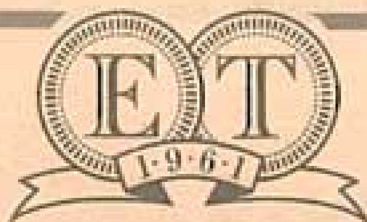

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Oil companies to blame for their current woes

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The refineries, in particular, those at coastal locations, viz., Koyali, Mumbai, are currently saddled with huge stocks of naphtha, fuel oil, LSHS, etc. This is primarily due to reduced offtake by major user industries who have switched over to cheaper imports.

The imports of these products were decanalised with effect from 1 April 1998 when the government decontrolled their prices and allowed oil companies to fix these, based on market forces. As the oil majors have been charging exorbitant prices, especially since May 1999, the users naturally find imports attractive. Hence, the problem of mounting stocks!

It may be pertinent here to have some insight into the pricing mechanism. Notwithstanding the freedom given to oil companies, they were expected to fix ex-refinery price on the basis of prevailing import parity price (IMPP) (this principle was introduced in September, 1997). However, they did not follow the principle in true spirit.

Instead of taking FOB price (which is realisation to global suppliers and would have also been the price realised by Indian refineries if they were to export) as the basis, the price was fixed on the basis of C&F, landed cost plus port handling charges (in case of fuel oil, even customs duty is loaded). On to this, a marketing margin was added to arrive at the ex-refinery price. All this led to an unjustifiably high price.

During the last quarter of 1999, for instance, corresponding to FOB price of US $214.0 per tonne, the ex-refinery price of naphtha at port location was Rs 11,680 per tonne (this included a hefty marketing margin of Rs 1150 per tonne). Had it been fixed on the basis of net-back from exports (FOB price minus ocean freight and expenses incurred at port), price would have been Rs 8350 per tonne. Thus, oil companies were over-charging to the extent of Rs 3330 per tonne.

The cost of supplies from refineries increases further on account of cascading effect of sales tax, which in some states like Gujarat is a high of 20 per cent. Thus, on the base price of Rs 11,680 per tonne, cost of naphtha delivered at plant site works out to a whopping about Rs 14,500 per tonne. In this, sales tax component alone is Rs 2500 per tonne.

As against this, in the import route, user industries would incur a cost of about Rs 11,000 per tonne which includes Rs 10,530 per tonne towards C&F cost and handling at port (there is clear saving on marketing margin) plus transport cost from port to plant site. It is important to note that no sales tax is levied on imported product. While, these comparative costs pertain to end 1999, at current levels also, the picture is broadly similar leading to reduced offtake and high stocks.

Even as oil companies are seeking from government the so-called level playing field vis-a-vis imports, they need to set their own house in order. For decades, they have got used to 'monopolistic' pricing of petroleum products. This was under the controlled regime and when domestic supplies were substantially short of requirement. Now, with build up of refinery capacity on a large scale particularly in the private sector (Reliance alone accounts for about one-fourth), we have a situation of surplus. Besides, the import option is also available.

The oil companies should, therefore, seriously consider drastically reducing prices. Instead of pointing fingers at users, as to what it would cost them if they were to import, they need to assess what they will realise by exporting the surplus. In other words, they should price the products on FOB basis.

The cost of domestic supplies can be brought down further if states reduce the sales tax. For instance, the Gujarat government should charge no more than 4 per cent. By facilitating higher quantum of domestic sales, this would also help in maintaining their revenue.

(Dr Gupta is chief economist, The Fertiliser Association of India, New Delhi. These are his personal views.)