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Arbitrary computations

The one-sided perception of the prices of petroleum products is inequitable, says **Uttam Gupta**

IN recent years, the administered pricing regime has come in for much criticism and has, in fact, even been dismantled for some industries. Deregulation has been justified in terms of the need to reduce budgetary support and foster increased competition which would ultimately benefit consumers by way of lowering selling prices and augmenting availability and better services.

Of late, even oil companies are demanding deregulation of prices of a wide range of products manufactured by them; the prices that have all along been administered by the government and with favourable effect on their profitability. The oil companies may not wholeheartedly admit this fact and might even take a contrary view by citing the so-called subsidies that they are forced to give on kerosene, high speed diesel oil (HSDO), LPG and naphtha/LSHS for fertiliser use.

They might even talk of the inadequacy of the resources for supporting expansion and modernisation. But, that is not the same thing as resources not being generated at all. The generation aspect can't be controverted. It is a different matter that the unprecedented surpluses in the oil pool account generated through systematic and, some times, even steep increases in the administered prices, have all along been utilised by the government for reducing its fiscal deficit.

The government has pumped in Rs 20,000 crore into the Oil Industry Development Board (OIDB) through a cess of Rs 900 on every tonne of crude oil produced in the country. Whereas the money was meant for supporting expansion and promoting R&D, only about Rs 900 crore were used for the purpose.

Quite clearly, the fact that the administered pricing regime in the past constrained the ability of oil companies to maintain high profitability and generate surpluses is a myth. On the contrary, the system has enabled them to pursue this goal with impunity and at the cost of user industries. What are they up to now? Already, they have given an indication of the possibility of a steep increase in prices within two or three years.

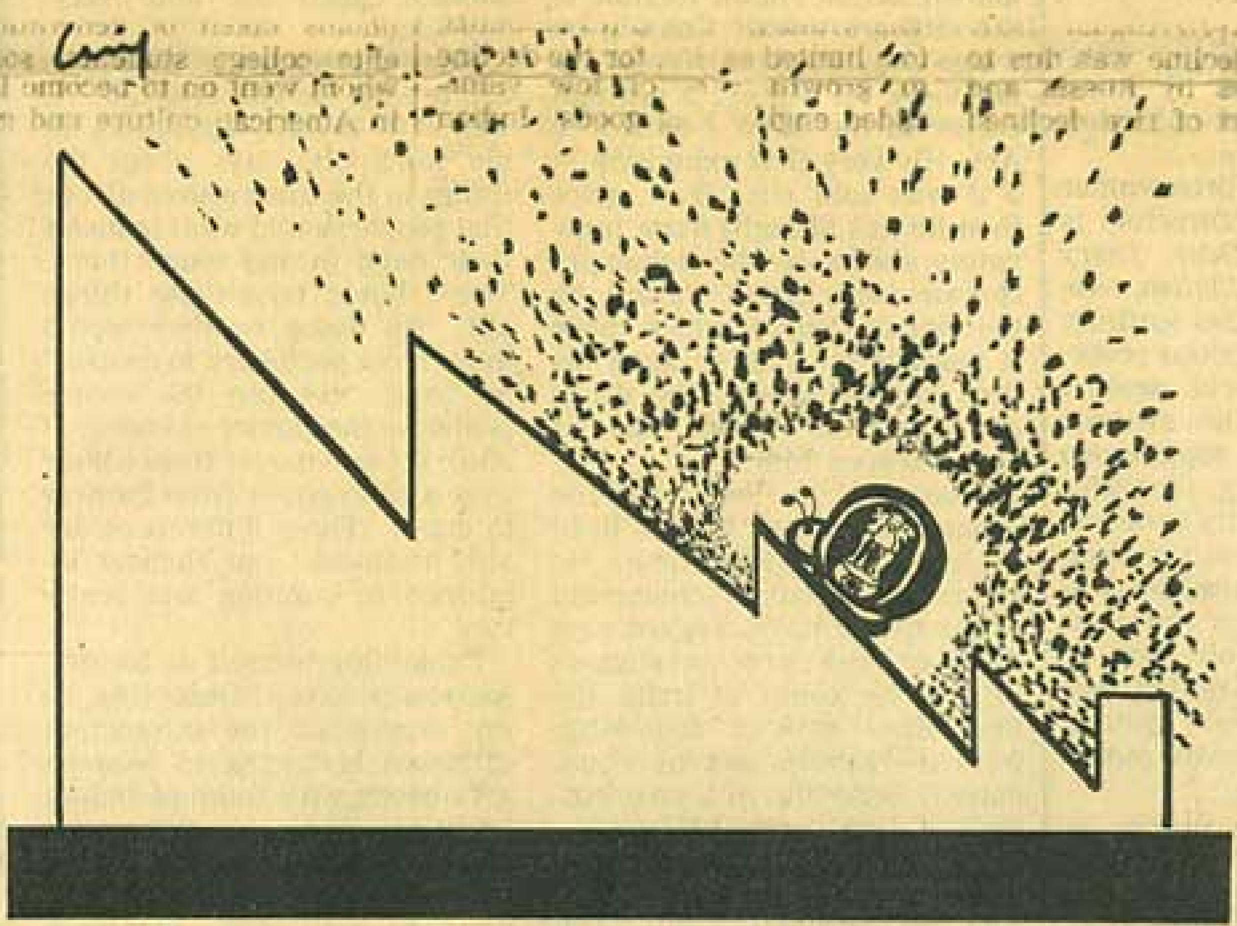
This is being proposed even for the so-called subsidised items — kerosene, HSDO, LPG etc, for which they want initially the subsidy amount to be maintained at the existing level, thus implying that the future increase in production cost will have to be borne by the user industries and consumer. Needless to mention that consequent to deregulation, even the existing subsidy amount would stand eliminated.

It may be argued that if increase in price were the sole consideration, the result could as well be achieved within the existing dispensation. After all, the government which is on the board of these companies did so in the past and nothing can prevent it from doing it even now. However, if the increase comes about in this manner, the government can't escape responsibility for contributing to inflation.

If, on the other hand, the government first deregulates and then prices are raised, it would be deemed as a commercial decision of the enterprise.

There are precedents. The deregulation of the steel industry in early 1993 was followed by significant increase in prices by SAIL after a very short interregnum. In the steel sector, there is significant presence of private sector and the possibility of competition. On the ground, both public and private industries have acted like a cartel. Oil is the exclusive monopoly of the government and the possibility of any check on its proposed actions in raising prices is simply ruled out. Although, oil and gas production has been opened up to the private sector, its involvement in any meaningful way is a distant cry.

There is no check on the monopolistic actions of the government-owned oil companies from the import side either. Last year, the government decanalised import of naphtha, fuel oil/LSHS and LPG and even allowed parallel marketing and distribution of these products through private networks. This too has not produced any smoothening effect on prices.



This is primarily because handling infrastructure at the ports is monopolised by oil companies and this also holds true of the internal storage and distribution network. The private entrants per force have to join hands with government companies in joint venture arrangements.

The emerging scenario for the oil companies thus looks extremely bright for another decade at least, even if current policies are pursued in right earnest.

From the user industries' perspective and for the hapless consumers, the conclusion is clear. They will be at the mercy of the oil companies. User industries which serve the high income and elite segments of the society will have no problem in assimilating increased prices of petroleum products. In contrast, consumers of kerosene, LPG and industries like fertiliser, which are meant for use by farmers, will be hit hard.

The oil companies have reportedly assessed the subsidy on petroleum products at Rs 8,500 crore. They want this to be completely eliminated. An exorbitant increase in prices will surely follow.

A few vital questions relating to production cost, the extent of subsidy and related issues bordering on accountability need to be asked.

How are production costs computed? Herein, it is not merely a question of broad parameters of pricing and the rate of return allowed. Are computations based on efficiency norms? Is there any norm for allowing investment cost or are these simply permitted on actuals basis? How are fixed costs apportioned between different lines of activities?

There is total lack of transparency on these fundamentals which gets accentuated because of the monopoly position of the oil companies and the "take it or leave it" approach adopted by them. A figure on what should, in the view of the management, be the price is dished out, compared with the price actually fixed for the users and subsidy amounts unilaterally and arbitrarily determined. For instance, the ex-refinery price of naphtha for non-fertiliser use is currently Rs 7,000 per tonne whereas for fertiliser it is Rs 3,700 per tonne.

Using the former as the benchmark, oil companies arrive at a subsidy figure on fertiliser equivalent to the difference between the two. What is the certainty that the amount being charged to non-fertiliser industries is the true cost?

Imported naphtha at the prevailing C&F landed cost is no more than Rs 5,000 per tonne. Clearly, on this basis, the subsidy on supplies to fertilisers should be no more than the difference between what this industry pays and the cost of imports. Alternatively, the true cost of production based on efficiency norms needs to be ascertained and subsidy level determined on that basis alone.

The prevailing one-sided perception of the prices of petroleum products is not only inequitable, unjust and unwarranted but it can have a very serious adverse effect on the overall health of the national economy.