

Delinking LNG from oil prices vital

Uttam Gupta

THE Government is reportedly contemplating a slew of fiscal measures aimed at making the cost of imported LNG (liquefied natural gas) competitive *vis-à-vis* domestic natural gas and ensuring its availability to consumers, especially the power and fertiliser industries, at an affordable price. At the outset, let us take note of the fiscal environment in which the promoters of LNG projects find themselves.

First, imported LNG attracts a basic Customs duty of 5 per cent. Second, import of capital goods for setting up LNG projects viz., LNG terminal and re-gasification facility attract a basic Customs duty of 25 per cent. Third, on sale of gas, States levy sales tax varying from a low of 4 per cent in Madhya Pradesh to a high of 20 per cent (plus 10 per cent surcharge) in Gujarat.

With these levies, according to an estimate based on the f.o.b. price of \$2.53 per million Btu (benchmarked to the crude price of \$20 per barrel), the delivered cost of re-gasified LNG to a plant located in Gujarat works out to about \$4.95 per million Btu, or about Rs 9,500 per thousand cubic metres (based on the calorific value of 10,000 kcal).

Besides f.o.b. price, the other components of delivered cost are shipping cost of \$0.29 per million Btu, Customs duty of \$0.14 per million Btu, cost of re-gasification \$0.65 per million Btu, pipeline charges and marketing margin \$0.55 per million Btu, and sales tax of about \$0.8 per million Btu.

The fiscal incentives being considered include:

- (i) abolition of the 5 per cent basic Customs duty on imported LNG;
- (ii) removal of Customs duty on import of plant and machinery for setting up of LNG terminal, re-gasification facility, etc.; and
- (iii) levy of a uniform 4 per cent sales tax by treating gas as a 'good of national importance' under Section 14 of the Central Sales Tax Act.

These concessions will enable a reduction in the delivered cost of re-gasified LNG by \$0.90 per million Btu. This includes \$0.14 per million Btu due to removal of Customs duty on imported LNG, \$0.10 per million Btu in re-gasification cost (due to removal of Customs duty on import of capital goods) and \$0.66 per million Btu due to lowering of sales tax from 22 per cent to 4 per cent.

With fiscal incentives, the cost of re-gasified LNG will thus be \$4.06 per million Btu, or about Rs 7,900 per thousand cubic metres. The corresponding cost of domestic gas to a plant in Gujarat is about Rs 5,150 per thousand cu. m. (basic price of Rs 2,850 per thousand cu. m. plus roy-

alty, transport charge and sales tax). Therefore, LNG will still be costlier than domestic gas by about 55 per cent.

The Ministry of Petroleum and Natural Gas (MPNG) has proposed removal of the ceiling of Rs 2,850 per thousand cu. m. on the basic price of domestic gas and 100 per cent parity with international price of a basket of internationally traded fuel oils. Consequent to this, the price will be Rs 5,900 per thousand cu. m. leading to a delivered cost of about Rs 8,000 per thousand cu. m. Indeed, this is the same as the cost of re-gasified LNG.

The above may seem to give an impression that the suppliers of LNG are not off the mark. But that is no reason for them to feel complacent. The real test is whether their price offer will be acceptable to fertiliser and power industries. This, in turn, will depend on

Global suppliers of gas have to enter into long-term arrangements with promoters of LNG projects in India who, in turn, have to forge relationships with producers of fertilisers and power. For these relationships to be sustainable, the gas price should remain affordable and stable, and not arbitrarily linked to the international prices of internationally traded fuel oils.

the capacity of the consumers of fertilisers and power — namely, farmers and households — to pay for these.

In fertilisers, currently, the selling price of urea is controlled at a level of Rs 4,830 per tonne. The cost of production and distribution from gas-based plants, on an average, is about Rs 6,500 per tonne. This is at the prevailing gas cost of \$1.9 per million Btu to plants at landfall point/drawing on-shore gas, and \$2.5 per million Btu to plants on the HBJ. The shortfall is made up for by subsidy support from the Government.

There is enormous resistance to increasing the selling price. In fact, the Government has not even implemented the ERC recommendation for increasing the price by 7 per cent per annum beginning fiscal 2001-02. Now, if the gas price is increased to \$4 per million Btu, this will increase the cost of supply and, in turn, subsidy by about Rs 2,000-2,500 per tonne. If, due to budgetary constraints, the Government is unable to foot the bill, production will become unviable!

In the power sector also, the tariff is regulated.

On an average, a household is charged Rs 2 per unit. Farmers pay a maximum of Rs 0.5 per unit (in some States, they do not have to pay at all). Industries are charged at a higher rate primarily to cross-subsidise sale to farmers/households. On a net basis, State electricity boards (SEBs) realise Rs 1.5-2 per unit from sale of power.

This being lower than the cost of supply, the majority of SEBs incur losses.

As in fertilisers, in this sector also, there is enormous resistance to increases in tariff. Against this backdrop, if the fuel cost is almost doubled and there is no budgetary support either, this will render the operations of power plants unviable. The promoters of new projects — grassroots as well expansion — will be left with no option but to shelve their plans.

From the above, it is clear that the price expectations of the LNG promoters are a bit too high. Moreover, by talking too much about the need for fiscal concessions (as seen above, these account for only 20 per cent of the total cost), they are deflecting attention from the more important factors contributing to the high cost.

An overriding factor is the linkage of the basic price of LNG (at \$2.53 per

linking the gas price to the international price of crude. Being a developed country, while Japan may be able to absorb the wide fluctuations in the price, a developing country like India cannot afford to do so.

To get an idea of the likely scenario, let us consider this. If the average crude price of about \$28 per barrel this year is used as the benchmark instead of \$20 per barrel (used in calculations above), the price of re-gasified LNG will increase by about \$1 per million Btu. This will raise the production cost of urea by about Rs 1,200 per tonne and the cost of generating power by Rs 0.4 per unit. Can the producers pass this to consumers?

In view of above, there is no reason why the price of gas cannot be fixed on its 'own' instead of seeking artificial linkages. After all, global suppliers of gas have to enter into long-term relationships with promoters of LNG projects in India who, in turn, have to forge long-term relationships with producers of fertilisers and power. For these relationships to be 'sustainable', they should ensure that the price is 'affordable' and 'stable'.

In respect of domestic gas to be supplied from its recently discovered fields in Krishna-Godavari basin, Reliance Industries Limited (RIL) has offered a 'fixed' price of \$3.0 per million Btu on delivered basis.

It should be possible to reduce the price further to about \$2.0-2.5 per million Btu to make it affordable to the users (see *Business Line*, December 6, 2002).

If the suppliers of LNG are really interested in serving the Indian market, they should stop thinking in terms of seeking linkage with the crude price.

LNG projects, being highly capital-intensive, a 'fixed' price on committed offtake of large quantities is in the best interest of both the suppliers as well as the consumers. Ideally speaking, they should aim at the same price as indicated by RIL with some moderation on the lower side.

The Government, on its part, should desist from linking the price of domestic natural gas currently supplied by ONGC to the international price of a basket of internationally traded fuel oils.

This will serve the dual purpose of ensuring that while, on the one hand, the price remains affordable to the prime consumers — fertilisers and power — on the other, it sends the right signals to promoters of LNG projects.

(The author is Additional Director, (Economics), Fertiliser Association of India, New Delhi. His views are personal.)

million Btu f.o.b., this alone accounts for about 63 per cent of the delivered cost) to the international price of crude. The linkage is seriously flawed. In a strict sense, gas is not a replacement for oil. While the latter is used mainly for heating, the former is recognised primarily for its 'chemical' value.

The use of gas in the manufacture of fertilisers and petrochemicals (which is complementary, as the former uses a lower fraction hydrocarbon — methane — while the latter uses higher fractions) generates the maximum value for the economy. Even the US Natural Gas Policy Act recognises this by assigning second priority — on a scale of 1 to 10 — to the use of gas in the manufacture of fertilisers — that is, next only to its use in essential services.

The linkage of gas price with oil can also lead to serious problems at the operational level. Since the international price of oil is prone to wide fluctuations, this will 'automatically' lead to wide variations in the gas price. Industries such as fertilisers and power, which cater to consumers all along used to 'low' and 'stable' prices, cannot be run smoothly under a fluctuating input cost regime.

It may be pertinent to mention here that prior to first oil shock in 1973, Japan — a major importer of LNG — used to import gas at a 'fixed' price. Thereafter, perhaps, as a sop to the oil exporting countries, it agreed to