THE OBSERVER
OF BUSINESS AND POLITICS

MONDAY, DECEMBER 2, 1996

Floundering on arithmetic

The contemplated hike in POL prices again is totally unjustified and unethical, says Uttam Gupta

BARELY eighteen weeks after the steep hike of 15-30 per cent in the prices of petroleum products (POL) from July 3 1996, the government is contemplating yet another increase. Whereas the July increase was intended to cover the deficit in the Oil Pool Account (OPA), the reason dished out for the contemplated increase this time is also the same.

The government is foreboding a monumental deficit of about Rs 15,500 crore in the OPA by the end of the year, i e March 1997, as against Rs 9700 crore, projected earlier in July 1996. The latter figure makes one seriously uncomfortable even as one tries to recapitulate the numbers given at the time of the price hike in July 1996.

According to the figures released then, the OPA had a deficit of Rs 5700 crore as on April 1 1996. This would have gone up to Rs 11,700 crore by March 31 1997, but for the increase in the prices.

The increase in the prices of POL announced initially, was expected to generate savings of about Rs 9700 crore, thus lowering the year and deficit to only about Rs 2000 crore. However, following revision in the price hike of diesel to 15 per cent as against 30 per cent earlier, the deficit would have been higher at about Rs 4000 crore.

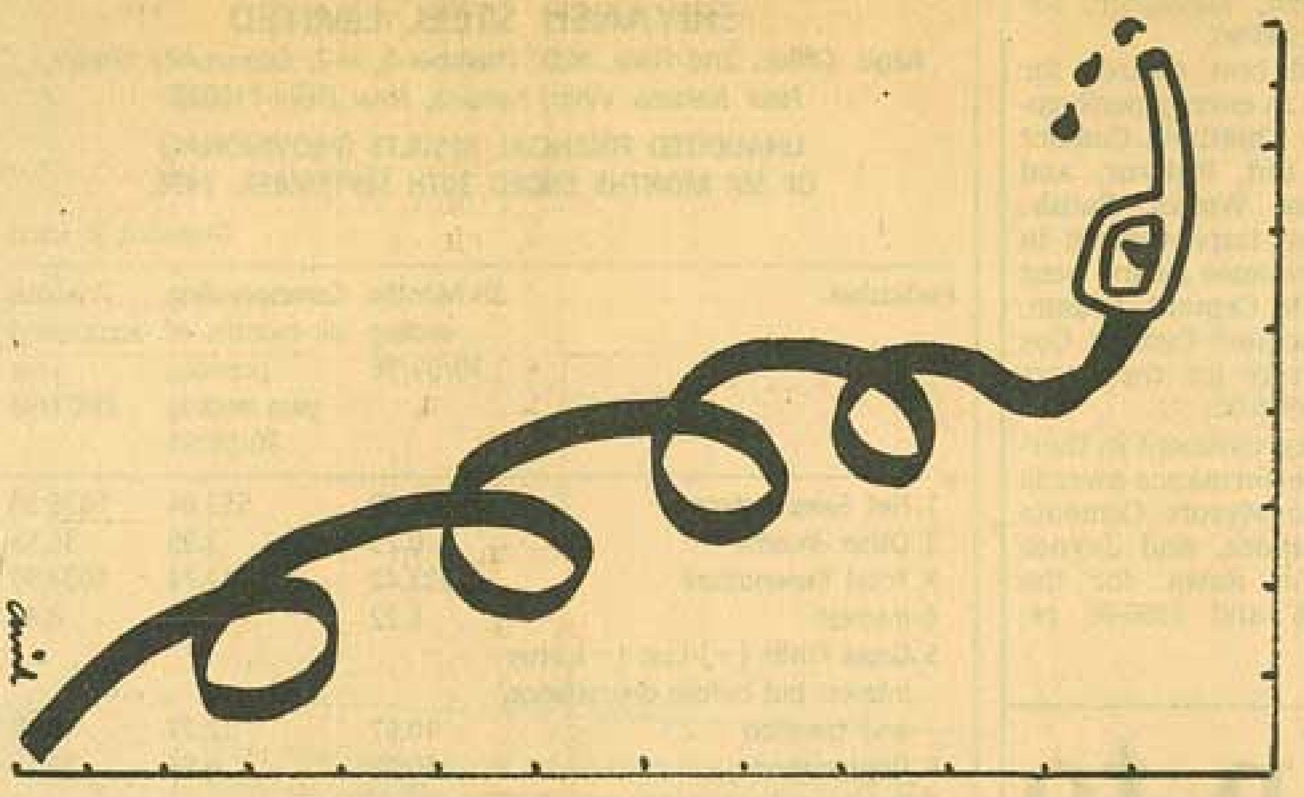
Assuming for a moment that the present version of July 1996 projection for March 1997, i e Rs 9700 crore, is correct, this would imply that the price hike of July 1996 yielded a small saving of only Rs 2000 crore (11,700 − 9700). This nullifies the tall claim of the government then that the price hike would wipe out bulk of the deficit. Alternatively, there is something seriously wrong with the figure released now.

On the basis that the end-March 1997 deficit will now be Rs 15,500 crore, the increase on account of post-July developments would be Rs 11,500 crore (15,500 − 4000), if the original July estimate is taken as correct, or Rs 5800 crore (15,500 − 9700) on the basis of the figure released now. In either case, the increase is substantial.

Apart from depreciation of the rupee, the increase has been attributed mainly to increase in import of crude/POL, and rise in the dollar price of crude. As regards the price, bulk of the purchases by IOC being on contract basis, the monthly variation in the price should not affect the outgo on such imports.

Even in regard to spot purchases, which are affected by price increases, it is unlikely that all such imports would be at the higher price, i e $22 per barrel obtaining in early November, 1996; indeed, the price has already come down to $19 per barrel. Despite this, working out the arithmetic at the higher price for entire purchases would lead to gross over-estimate.

No doubt, the decline in domestic production of crude, and spurt in demand for petroleum products are exerting pressure on imports. These trends could not have been unknown in July, 1996. If, however, the government feels that these are unexpected, then this is, to say the least, bad planning.



Unrestrained growth in imports for POL clearly indicates lack of demand management. For instance, because of tardy progress in setting up new power projects, failure to improve the plant load factor (PLF) of existing stations, and reduce transmission and distribution (T&D) losses, the industries and businesses are setting up on a large scale, captive power plants and diesel sets to overcome the power shortages. The resultant unprecedented increase in demand for fuel oil/LSHS/diesel could have been avoided by better planning and execution of projects.

In recent years, there has been a virtual explosion in the automobile sector, particularly in the private vehicles segment. While this may have contributed to rapid industrial growth, the impact of this on the demand for POL and, in turn, imports cannot be brushed aside. This is environment-unfriendly as well.

Energy conservation across-the-board, i e industry, transport, agriculture and services etc, offer enormous potential for reducing demand for POL and, in turn, dependence on imports. And yet, it is given lip service only. Sincere and purposeful efforts are needed to improve energy efficiency in various sectors.

Through proper and effective management of demand, the pressure on OPA can be greatly reduced. In the context of the present deficit, however, there is need to take a holistic view of the situation in a dynamic perspective. While the developments during the current year and, to some extent, in 1995-96, may be disturbing, the entire decade of 1980s and even the early 90s, i e up to 1994-95, was good for the OPA.

During the 80s, with inflows into the OPA being higher than the outflows for most of the period, there was an accumulated surplus of about Rs 9000 crore at the end of the decade. Thereafter, up to 1994-95, while on the one hand, the prices of imported crude and POL declined sharply, on the other, the selling prices of POL products were raised in July 1991, September 1992 and February 1994.

Whereas, the surplus at the end of 80s, was appropriated by the government to reduce its budget deficit, in the 90s, at the end of 1994-95, the OPA showed a deficit of about Rs 3800 crore. Despite favourable circumstances, this was quite unusual.

In view of the above, the OPA should have been in a healthy state. Contrary to this, it is severely strained because the surplus was misused when the going was good and even after that, the pressure has been largely due to mismanagement. The lack of transparency and accountability has made matters worse.

The contemplated hike in POL prices is totally unwarranted and unjustified, even unethical. At the outset, the government should set the basic facts straight in regard to the quantum of deficit. This is necessary to instil confidence amongst the user-industries and general public.

To lower the deficit, it should reduce the customs duty on imported crude and POL products. This will only be fair and equitable as, in recent years, the government has benefited substantially by way of higher revenue due to the rupee depreciation alone. It may also consider reducing the royalty and excise duty on indigenous supplies of crude.

Alternatively, the government should provide budgetary support to plug the deficit in the OPA. For the future, as and when there is surplus it should refrain from using the same for meeting its budgetary needs. Instead of the Oil Coordination Committee (OCC), the task of operating the OPA 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 retention margins (RM) for refineries, the methodology of computations and modalities for use for funds, etc.

Representatives of user-industries and important consumer associations should be associated with the exercise to ensure transparency and accountability.