

Gas price: De-regulation brooks no delay

UTTAM GUPTA

PETRONET LNG has not been able to sew up agreements for supply of re-gasified LNG (liquefied natural gas) from its recently commissioned terminal at Dahej (Gujarat) to the fertiliser manufacturers. This is because the latter are unwilling to pay the price — about \$5 per million Btu — at which the supplies would be viable.

Currently, the fertiliser industry accounts for about 40 per cent of the total consumption of DNG. And given its growth potential (due to its inextricable linkage with agriculture), it will continue to be a major user of the gas. This is clearly recognised in 'Hydrocarbon Vision 2025', a document released by the Prime Minister's Office last year.

The supply of DNG from existing sources being grossly inadequate vis-à-vis the demand, it will have to be supplemented by re-gasified imported LNG and additional supply of DNG from new sources. This will be possible only if pricing of gas is made attractive to the suppliers. At the outset, we need to know how DNG from existing sources is priced. This is important as the fertiliser industry has sought to use the prevailing price of DNG as benchmark during its negotiations with Petronet LNG and will be doing so with other players as well.

In 1991, a Committee headed by Dr Vijay Kelkar (the then Chairman, Bureau of Industrial Costs and Prices) had recommended that the price of DNG should be fixed at 100 per cent parity with the import parity price of fuel oil. It recommended a separate price for the producers based on the production cost of a marginal field in the South Bassein region.

Based on the above principle, the Committee arrived at a price of Rs 2,000 per thousand cubic metre. However, recognising that fixing the price at this level would mean a steep increase over the existing level of Rs 1,400 per thousand cu m at one go, it recommended that this be reached over a period of three years. From January 1992, the Government fixed the basic price of DNG at Rs 1,550 per thousand cu m while allowing a price of Rs 1,500 per thousand cu m to the producers. Concurrently, it established the Gas Pool Account, where the differential between the price paid by the consumer and the price allowed to the producer was deposited.

Thereafter, the price to the consumers was increased by Rs 100 per thousand cu m per annum to reach Rs 1,850 per thousand cu m by January, 1995. The price was kept at this level up to September 30, 1997.

This was in sharp contrast to the target price of Rs 2,000 per thousand cu m

from January 1994, as per the Kelkar Committee recommendation.

All these years, the producer's realisation remained unchanged, at Rs 1,500 per thousand cu m. This meant that all subsequent increases in payments by the consumers were deposited in the Gas Pool Account. Clearly, ONGC did not get the benefit of increase in consumer price.

In October 1997, based on the recommendations of a Committee under the Chairmanship of Dr P. L. Shanker (then Principal, Administrative Staff College of India, Hyderabad), the Government decided to link the basic price of DNG to a basket of imported fuel oils at 55 per cent in the first year, 65 per cent in the second year and 75 per cent in the third year.

This in itself was a significant watering down of the earlier Kelkar pre-

in a totally ad hoc and arbitrary manner (despite the recommendations of both the Kelkar and Shanker Committees). At Rs 2,850 per thousand cu m, it neither reflects its opportunity cost nor is it based on the production cost approach.

The existing price structure also discriminates among various producers. While private producers of DNG, including joint ventures, are paid on the basis of 100 per cent parity with the import price of fuel oils (about Rs 6,000 per thousand cu m), the price paid to ONGC — about Rs 2,500 per thousand cu m — is even lower than the basic price paid by consumers.

The users of DNG located in the North-East region get supplies at a heavily subsidised price of just Rs 1,700 per thousand cu m (there exists a provision for discount of Rs 300 per

fuel oils. This would enable ONGC to pursue its production enhancement programme at an accelerated pace. This, in turn, would help the gas-based fertiliser units get their full requirements of gas, thereby obviating the need to use costlier naphtha (currently priced at \$8 per million Btu). The existing naphtha and fuel oil based plants will also be able to switch over to gas.

As a result, while naphtha/fuel oil based plants will be able to drastically cut their energy costs, the cost to gas-based plants will also be no more than what it is now. Needless to say, the fertiliser industry would reap the benefit of using a much better fuel; one that is cleaner, promises lower energy consumption and is less damaging to equipment. A realistic pricing of DNG would also help LNG players reach satisfactory pricing agreements with the users. At present, as amply demonstrated in case of Petronet LNG, the fertiliser producers cite the prevailing low/artificially suppressed price of DNG, thereby blocking chances of a viable deal.

This would also instil confidence in companies that have in recent times, discovered huge reserves of domestic gas but are reluctant to put these to commercial use due to the continuing uncertainties of gas pricing.

What, then, is preventing the Government from allowing the price of DNG to find its own level based on market forces? It is, perhaps, the fear of increase in the fertiliser subsidy. But this has to do primarily with the cost plus Group Concession Scheme for urea.

Under the scheme, any escalation in cost of inputs, including gas, is automatically reimbursed to the producers as subsidy. This problem will not arise if the group concession scheme is abandoned and replaced by a system of making payments to urea producers on the basis of the prevailing import parity price of urea.

The removal of price and distribution controls on DNG brooks no further delay as this alone will provide the necessary impetus to the suppliers of gas — both domestic and imported — to do all that is needed to augment supply to the level of projected demand and thus help achieve full energy security.

The Government should also keep in mind the fact that it marketed the sale of its equity holding in ONGC (the proceeds from this were a staggering over Rs 10,000 crore) *inter alia* on the strength of deregulating the gas sector and its attendant benefits. To keep the decision in abeyance now would amount to renegeing on the promise to investors.

The removal of price and distribution controls on domestic natural gas brooks no further delay if the suppliers of gas — both domestic and imported — are to get an impetus to augment supplies to the level of projected demand and help achieve full energy security.

scription (requiring 100 per cent parity).

Ironically, the principle of parity, even at less than 100 per cent, was not observed as, by prescribing a band of Rs 2,150-2,850 per thousand cu m, the Government never allowed the price actually charged from the consumers to exceed Rs 2,850 per thousand cu m. Since October 1999, the price has remained at this level (at the applicable 75 per cent parity, it should have been about Rs 4,400 per thousand cu m in 2003). After dismantling the administered price mechanism for petroleum products from April 1, 2002, the Ministry of Petroleum and Natural Gas has been asking for removal of pricing and distribution controls on the gas sector and seeking linkage of the DNG price at 100 per cent parity with fuel oils. This is being opposed by the Department of Fertilisers.

The divergent positions taken by the Ministries/Departments concerned led to the constitution of a Group of Ministers under the Chairmanship of Mr K. C. Pant, former Deputy Chairman, Planning Commission last year. The Group ducked the key issue of evolving a viable price structure. It merely recommended a modest increase of Rs 350 per thousand cu m in the basic price of DNG and directed the Tariff Commission to examine the production cost structure of ONGC and OIL.

At present, the price of DNG is fixed

thousand cu m on a case to case basis). The consequential loss incurred by OIL — the supplier — is supported by the surplus generated from the sale of ONGC gas.

There is discrimination in regard to transport charges as well. No matter where a user is located, the charge is the same, at Rs 1,150 per thousand cu m. Thus, a unit located in Gujarat near the point of origination of gas (at Hazira) has to pay the same rate as one located thousands of km away — say, in UP. The existing structure of DNG pricing neither gives users the necessary signals to make the right choices in regard to feedstock/fuel nor producers the incentive to optimise production and invest in exploration and development of fields.

The control on DNG price at an artificially low level has led to pent-up demand in the fertiliser sector, a significant portion of which remains unmet. As a result, the gas-based fertiliser units are forced to use costlier naphtha (in some cases to the extent of 50 per cent) to run the plants at optimum load.

All these distortions can be eliminated if only the Government removes controls on the price of DNG and allows this to be determined by market forces. Contemplate a scenario in which ONGC gets the right price based on 100 per cent parity with import

(The President Director, ONGC, New Delhi. His views are