Editorial

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Gas price hike plan

Another blow to the core sector

The Government should refrain from implementing the Shankar Committee recommendations if it wants to prevent the devastating effect of pricing out important core industries such as fertilisers and power, without in any way contributing to the development of the gas sector, says Uttam Gupta.

THE sword of price hike hangs over the fertiliser industry. Already, in the 1990s the price of natural gas has been hiked substantially. Before January 1, 1992, the price was Rs. 1,400 per 1,000 cubic metre for off-shore gas at landfall point and on-shore gas, and Rs. 2,250 per 1,000 cu. m. along the HBJ (Hazira-Bijaipur-Jagdishpur) pipeline. The difference of Rs. 850 went towards transportation cost through the HBJ. As for the plants in the North-East, there was a concessional price of Rs. 1,000 per 1,000 cu. m. with the provision for a discount of up to Rs. 500 per 1,000 cu. m.

With effect from January 1, 1992, based on the Kelkar Committee recommendations, the prices were revised to Rs. 1,550 per 1,000 cu. m. for offshore gas at landfall point and on-shore gas, and Rs. 2,400 along the HBJ pipeline. Thereafter, the price was hiked by Rs. 100 per 1,000 cu. m. per annum for three years in succession leading to Rs. 1,850 for offshore at landfall point/on-shore and Rs. 2,700 for HBJ location respectively with effect from January 1, 1995. For plants in the North-East, since January 1, 1992, the price has been maintained at Rs. 1,000 even as the provision for discount was reduced to Rs. 400 per 1,000 cu. m.

To review the natural gas pricing policy and recommend changes in the pricing structure with effect from January 1, 1996, the Government constituted, in 1995, a committee under the chairmanship of Mr. T. L. Shankar, Principal, Administrative Staff College of India, Hyderabad. In its report submitted to the Government in October 1996, the Committee reportedly recommended a basic price of Rs. 3,000 per 1,000 cu. m. along the HBJ pipeline while retaining the basic price of offshore gas at landfall point and on-shore gas at Rs. 1,850. For five years thereafter, an increase of Rs. 200 per 1,000 cu. m. per annum was proposed.

The Committee is reported to have modified its recommendations recently with regard to the basic price in the first year. It has now proposed Rs. 2,050 per 1,000 cu. m. for offshore gas at landfall point and on-shore gas, and Rs. 3,200 for plants along the HBJ pipeline. The recommendation with regard to increases in the successive five years — Rs. 200 per 1,000 cu. m. per annum — stays.

While the proposed increase in the basic price is substantial, the effective increase in the cost of natural gas to the plants will be even higher due to the cascading effect of royalty, of 10 per cent; Central sales tax 4 per cent, besides sales tax which, though varying among States, is, on an average, 5 per cent. Thus, for the first year — 1997-98 — the price of gas to the plants located at the landfall point or using on-shore gas would increase from about Rs. 2,300 per 1,000 cu. m. to Rs. 2,600, that is, by Rs. 300. For plants along the HBJ pipeline, the effective price charged to plants would go up from about Rs. 3,000 to Rs. 3,600 — an increase of Rs. 600.

A gas-based plant needs about a million K-Cal of energy to produce a tonne of urea. Of this, the main process plant's requirement alone — about 5 million K-Cal — is met by gas supply; for the balance — energy needed for running the captive power and steam generation plants — alternative fuels such as naphtha/fuel oil have to be used (under government directive). Taking the calorific value of the gas at about 1 cu. m. = 8,400 K-Cal, 5 million K-Cal are generate from 600 cu. m. of gas. In view of this, the proposed gas price hike will increase the urea production cost for on-shore/landfall point plants by Rs. 180 per tonne and that of plants along the HBJ pipeline by Rs. 360 per tonne.

If, however, the Government implements the Shankar Committee package *in toto* — an increase of Rs. 200 per 1,000 cu. m. for five successive years beginning 1998-99 — then, by 2002-03, the basic price at the landfall point/on-shore gas will be Rs. 3,050 and, for HBJ plants, Rs. 4,200. The effective price at the plant site — including royalty and sales tax (Central and at the existing rates) — will be Rs. 3,700 for the landfall point/on-shore plants and Rs. 4,700 for HBJ plants. Over the existing levels, these would represent an increase of Rs. 1,400 for the landfall point/offshore plants and Rs. 1,700 for the HBJ plants. The corresponding increase in urea production cost will thus be Rs. 840 per tonne and Rs. 1,020 per tonne respectively.

Under the retention pricing and subsidy scheme (RPS), the excess of the reasonable cost of production and distribution over the controlled selling price is given as subsidy to the manufacturers. In view of this, the increases in the cost of production, consequent to the gas price hike, will lead to a corresponding increase in the subsidy payment by the Government. The cumulative impact of the price hikes in natural gas, as recommended by the Shankar Committee over a six-year period beginning 1997-98, will be about Rs. 4,000 crores. Adoption of the Committee's recommendations would, thus, run contrary to the overall objective of containing growth in fertiliser subsidy.

In this context, it may be recalled that to contain the ballooning of the fertiliser subsidy and to rationalise the price of various hydrocarbon feedstocks, the Joint Parliamentary Committee (JPC), in August 1992, recommended a reduction in the price of natural gas by 35 per cent, removal of royalty on gas and rationalisation of the transport cost to bring it down to a reasonable level. The Committee also recommended freezing of the price of hydrocarbon feedstock, naphtha, fuel oil and LSHS at the existing levels.

Unfortunately, these were observed more in the breach. The prices of naphtha, fuel oil and LSHS were raised in September 1992 by 36 per cent, 54 per cent and 54 per cent respectively, followed by a further steep hike of 30 per cent each in July 1996; even the gas prices were increased successively until January 1, 1995.

Moreover, this will lead to a further widening of the gap between the reasonable cost of production and distribution, on the one hand, and the selling price, on the other. Needless to say, this would hamper the prospects of introducing reforms in the urea sector without, at the same time, affecting consumption and production. The experience of phosphatic and potassic fertilisers, when they were suddenly decontrolled in August 1992 despite a yawning gap between the cost and selling price, is still fresh in the country's mind.

The high-powered fertilisers pricing review committee, under the chairmanship of Dr. C. H. Hanumantha Rao, former member, Planning Commission, is reviewing the RPS and has the mandate to suggest modifications in the system or other alternatives, for instance, in import parity pricing, dual pricing, or a free market-based system. In the event of the RPS being replaced by such policy alternatives, leading to a withdrawal of the subsidy cover, the high production cost, induced by the increasing feedstock cost, including natural gas, could make them highly vulnerable and even threaten their viability.

That there are serious lacunae in the existing gas price structure were pointed out by none other than the JPC. Thus, it said: "The price of natural gas supplied to the fertiliser industry does not seem to reflect its true cost. The committee notes that about 22 per cent of the total gas produced is flared by ONGC for want of facilities and the cost of gas so flared during the last two years — 1989-90 and 1990-91 — alone, amounted to as much as nearly Rs. 1,800 crores. The committee notes that for determining the consumer price of natural gas, the cost of imported furnace oil is taken as the basis which has no relation to the actual cost of production. Similarly, the producer price of gas is reportedly based on the cost of production of gas from South Bassein field. This does not take into account the weighted average of the cost of gas from other sources including the cost of gas flared. In view of these facts, the committee recommends that the gas price should be fixed on a rational calculation of production cost based on total production."

Instead of correcting these anomalies by implementing the relevant JPC recommendations, the Government's contemplated move to further increase the gas price is unwarranted and unjustified.

At the centre of the Shankar Committee recommendations is the steep increase in transportation charges along the HBJ pipeline, from Rs. 850 per 1,000 cu. m. to Rs. 1,150. In this context, it may be recalled that, in the late 1970s/early 1980s, while examining the comparative economics of setting up fertiliser plants on-shore and moving the finished product, urea, to the consumption centres — primarily in the northern belt — *vis-a-vis* setting up projects near consumption centres and supplying them with gas through the pipeline, the Government concluded that the latter was more cost-effective. This, indeed, provided the *raison d'etre* for laying the HBJ pipeline and setting up the gas-based fertiliser plants along it.

Unfortunately, by fixing the transport charge at an artificially high level of Rs. 850, this objective was defeated even as the cost of transporting urea all the way from on-shore locations turned out to be lower than that of moving equivalent quantities of gas through the pipeline. For instance, in respect of the Bijaipur plant of the National Fertilisers Ltd. the cost of moving urea by rail (train load) up to this point is Rs. 185.50 per tonne. Against this, the cost of transporting an equivalent quantity of gas is much higher at Rs. 510 per tonne (850 x 0.6). Consequent to the proposed increase in the transport charge to Rs. 1,150, this will go up further to Rs. 690 per tonne.

The committee has suggested that the increase of Rs. 200 per 1,000 cu. m. per annum for five successive year in the basic price be put into the Gas Pool Account (GPA) even as the realisation to the producer — ONGC — remains at Rs. 1,850 per 1,000 cu. m. This is a clear case of the Government benefitting at the expense of the gas-users. Although it is stated that the Government will use the GPA funds for gas sector development, one only needs to look at how contributions to the GPA were used in the past to conclude that even this objective has not been met. This will be clear from the marginal accretion to the overall gas supply in the 1990s.

Thus, the Government should refrain from implementing the Shankar Committee recommendations if it wants to prevent the devastating effect of pricing out important core industries such as fertilisers and power, without in any way contributing to the development of the gas sector.

(The author is Chief Economist, The Fertiliser Association of India, New Delhi.)