

Gas pricing: Key to energy security

The Government should abandon its 'irrational' approach of linking the gas price to the import parity price of fuel oils on the ground that it leads to better price realisation. In the overall interest of achieving energy security and giving the economy a boost, the Government should provide much-needed support to both private and State-sector projects relating to domestic gas. In particular, the required clearances should be given expeditiously, says **Uttam Gupta**.

THE discovery by Reliance Industries Limited (RIL) of gas reserves in Krishna Godavari Basin off the coast of Andhra Pradesh, near Visakhapatnam, has resulted in great optimism about the country's energy security. The reserves are estimated at a stunning 7.0 trillion cubic feet. Of these, the quantum that can be commercially exploited is 5.0 trillion cubic feet. From this, RIL has promised to deliver 40.0 million standard cubic metres per day (mscmd).

The Gujarat State Petroleum Corporation (GSPC) has stated that a block in the K-G Basin (allotted to it under NELP-III) has about 44.0 trillion cubic feet of reserves. Of this, about 10.0 trillion cubic feet can be commercially exploited. Proceeding on the same basis as RIL, GSPC should be able to supply 80.0 mscmd.

Imported LNG is another major source. Petronet-LNG (a consortium of IOC, GAIL and BPCL) has plans to deliver 30.0 mscmd from its proposed terminals at Dahej (Gujarat) and Kochi (Kerala). A number of projects in the private and joint sectors have also been lined up.

The supply of piped gas from other countries has also been in the news. For instance, UNOCAL — a US based multinational — intends to bring about 50.0 mscmd of gas from Bangladesh. For quite some time, it has been active in garnering support for this project.

In view of the above, a total of 200 mscmd of additional gas can be put on tap by 2006-07. Add to this the likely production from existing sources — 58.0 mscmd. Thus, during 2006-07, the total supply will be 258 mscmd. This will be higher than the projected demand of 231 mscmd (as per Hydrocarbon Vision-2025).

Clearly, the optimism is justified. However, the supply of gas *per se* has little meaning unless it is made available at a price 'affordable' to the users. Power and fertilisers alone consume about 75 per cent of the current gas production. Much of the incremental demand will also be contributed by these sectors.

The consumers of power and fertilisers are millions of farmers (the majority of them being small and marginal cultivators) and millions of poor households. Taking this into consideration, the Centre controls the selling of fertilisers at a low level, while the State governments heavily subsidise the sale of power to the farmers (some States give it free).

The Government is committed to eliminating subsidies on both power and fertilisers. This will require that, eventually, their selling prices are 'aligned' with the cost of supply. Now, if the price of feedstock/fuel (supplied mainly through gas) is high, this will lead to a high cost of producing fertilisers and power and, in turn, their price to the consumers.

Both these items being 'politically'-sensitive, the Government dare not allow increase in their selling price beyond a certain level. For instance, the Centre did not even implement the Expenditure Reform Committee's recommendation for a modest 7 per cent increase in the price of urea. Several States have not yet implemented the National Development Council (NDC) decision to charge a minimum of 50 paise per unit of power supplied to farmers.

The only way the interests of consumers of power and fertilisers can be protected with no subsidy support from the Government is by pricing of feed-

stock and fuel at low levels. And, yet, if the price of gas is kept high, this will hit the farmers and poor households. And go against the interests of suppliers as well!

The Reliance group Chairman and Managing Director, Mr Mukesh Ambani, is said to have indicated that RIL gas will be priced at \$3 per million Btu on a 'delivered' basis.

This means that all users, irrespective of their location, will get gas at this price. Unless stated otherwise, this should also imply that the price includes all statutory levies.

The corresponding price currently charged by Gas Authority of India Limited (GAIL) for supply of domestic gas from ONGC and other producers in the private/joint sectors is \$1.9 per million Btu to plants at landfall point/receiving on-shore gas, and \$2.5 per million Btu to plants along the Hazira-Bijaipur-Jagdishpur (HBJ) pipeline.

The above prices charged by GAIL have been computed from a basic price of Rs 2,850 per thousand cubic metre (plus transport charge of Rs 1,150 per thousand cubic metre applicable to plants along the HBJ). At Rs 2,850 per thousand cubic metres, the basic price works out to about 44.0 per cent of the import parity price (IMPP) of a basket of internationally traded fuel oils.

As per a formula adopted in 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 price should have been at 75 per cent parity with the IMPP of fuel oils but for the Government's decision to cap it. The ceiling was pegged at Rs 2,850 per thousand cubic metres.

The Government is now contemplating removing the ceiling and increasing the basic price of gas to 100 per cent fuel oil parity from April 1, 2003. After the hike, the price will be Rs 5,900 per thousand cubic metres. As a result, the users at landfall point or those receiving on-shore gas will pay about \$3.7 per million Btu. The effective price to users along the HBJ will be about \$4.3 per million Btu.

For imported LNG, Petronet-LNG has indicated that its price (benchmarked to the Japanese Cocktail Crude Index) at the Dahej terminal will be \$4 per million Btu. At the user point, the

price will be higher. The industries located in the 'hinterland' may end up paying an amount in excess of \$5 per million Btu.

Clearly, the price of RIL gas will be significantly lower than that of ONGC gas (post-revision) as well as supplies from other existing producers in the private/joint sector.

It will be substantially lower than the price of imported LNG. On the other hand, piped gas from Bangladesh could, perhaps, match the RIL price. Significantly, the price of \$3 per million Btu offered by RIL is also substantially lower than the price of naphtha and fuel oil (a sizeable chunk of existing fertilisers and power capacity is based on these) at about \$7-7.5 per million Btu and \$5.5-6.5 per million Btu respectively.

At the RIL price offer, the fuel cost for generating one unit of power works out to about Rs 1.2 (2,000 kilo-calories for a kilo-watt hour). The feedstock/fuel cost of producing a tonne of urea is about \$72 (24.0 million Btu for a tonne of urea). The price is attractive to such other industries as petrochemicals and sponge iron too.

There is scope for RIL to aim at a price even lower than \$3 per million Btu. To get an idea, let us consider the following. On per cubic metre basis, this price works out to about Rs 6. On supply of 40 mscmd, this will yield revenue of about Rs 24 crore per day, or Rs 8,760 crore per annum.

After deducting about 20 per cent towards various levies (royalty, CST and local taxes), the net-back from sale of gas will be about Rs 7,300 crore per annum.

At this rate, after allowing for running cost (in such highly capital-intensive projects, this is a small portion of total cost), RIL will be able to recover the investment in a time span of 3-4 years.

In order to bring about further reduction in price to, say, \$2.5 per million Btu (currently paid by users along HBJ for ONGC gas) or even lower, RIL may have to make a little sacrifice in reconciling itself to recovering the capital cost over a somewhat longer time horizon.

As per reports, RIL intends to increase the supply from its K-G/D fields to 100 mscmd. Indeed, the extra quan-

ties — that is, 60 mscmd — will be available at a substantially lower investment cost. This will provide additional leeway in bringing about the desired price reduction.

In respect of ONGC gas, the Centre should endeavour to maintain the price at the existing level. In any case, the price should not exceed \$3 per million Btu. When, from a newly discovered field, RIL can promise this price, there is no reason why ONGC cannot match it in respect of supplies from fields discovered long ago.

The Government will have to abandon its existing 'irrational' approach of linking the price of gas to the IMPP of fuel oils. It should not hang on to this simply because its adoption leads to better price realisation. The pricing of gas should stand on its own, especially when global trade in gas is poised to take quantum jump.

In the overall interest of achieving energy security, reducing subsidy and giving the economy a boost, the Government should give the much-needed support to the projects of RIL and GSPC in regard to domestic gas. In particular, the required clearances should be given expeditiously.

To keep up pressure and promote competition, the projects for imported LNG need to be given a level playing field. At present, LNG imports attract 5 per cent Customs duty. This should be withdrawn. The Government may also consider exempting import of capital goods used for putting up LNG infrastructure from levy of Customs duty.

The fiscal incentives alone will not help Petronet-LNG lower the price to the desired level. For this, it will have to re-negotiate its deal with RAS-GAS (the Qatar-based supplier of LNG). The deal should be so restructured as to ensure a price in the range of \$2-2.5 per million Btu at Dahej.

It is possible to have access to the gas from Bangladesh at fairly competitive price. In fact, UNOCAL should be in a position to match the price offered by Reliance. The Government should make efforts at the political level to ensure that this gas reaches India.

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