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Neither viable, nor sustainable

Only a package on the basis of transparency in the oil pool account can tackle the oil pool deficit, says **Uttam Gupta**

BARELY 14 months after the hefty increase of 15-30 per cent in the prices of various petroleum products sans kerosene in July 1996, the government has imparted yet another blow. The price of petrol is up by 5 per cent, diesel 26 per cent and LPG by 12 per cent from September 2, 1997. The price of kerosene, however, remains unchanged. The steep increase in the price of diesel in particular, i e, 26 per cent — against 15 per cent hike in July 1996 — will trigger off an unprecedented inflationary spiral covering transport, agriculture and a wide range of industries.

The government has also jacked up the prices of naphtha, fuel oil, LSHS etc in a manner that the common man would not easily notice. This has been done by withdrawing the concessional price on supplies to fertiliser units and simultaneously linking the price to import parity price (IMPP). The ex-refinery price of naphtha on supplies to fertiliser industry will, thus, go up from existing Rs 4840 per tonne to Rs 7624 per tonne i e a whopping 57.5 per cent. Likewise, the ex-refinery price of fuel oil increases from Rs 3916 per tonne to Rs 5507 per tonne i e 40.6 per cent and that of LSHS from Rs 3707 per tonne to Rs 6089 per tonne i e 64.3 per cent.

These increases will further push up the cost of production of urea and that of complex phosphatic fertilisers — the latter by using ammonia supplied by naphtha/fuel-oil based indigenous plants — to new heights. For the urea industry, this would raise the subsidy bill under the retention pricing and subsidy scheme (RPS), by about Rs 1500 crore per annum. For the phosphatic products also — not covered by the RPS — subsidy amount under the scheme of ad hoc concession will have to be raised to maintain selling price at existing level.

Since any increase in subsidy adds to the fiscal deficit, there will be pressure on the government to initiate measures to reduce it. In view of this, the possibility of increase in fertiliser prices to the farmers is therefore not ruled out. Ultimately, the cost of food and other agricultural products will increase further, adding to the inflation.

The ball does not stop at the present price hike. By deciding to link the price of diesel, naphtha, fuel oil, LSHS etc, to the IMPP and revise these on a monthly basis, the government has ensured that the users should be prepared for more and more shocks on a continuing basis. The international price of naphtha is highly volatile and has a tendency of shooting up in the event of increase in import demand. This is unavoidable in view of government's recent decision not to make domestic

naphtha available to new fertiliser projects and uncertainties of supplies to existing units.

Such a heavy price this has been to the rest of the economy — and that too on a perpetual basis — only with a single point programme of tackling deficit in the OPA without even bothering to analyse the causes. The package announced by the government is primarily two-fold, i e (i) that it deals with incremental deficit and (ii) tackling the accumulated deficit.

On 'i', the hike in PoL prices will yield a saving of about Rs 9700 crore per annum and about Rs 6000 crore during the current year. Considering that the deficit was expected to grow at the rate of Rs 30 crore per day or Rs 900 crore per month, the incremental deficit would thus be almost fully eliminated during the current year itself.

As for the accumulated deficit of about Rs 20,000 crore as of end-August 1997 — Rs 15,500 crore up to end-March 1997 and further build-up of about Rs 4500 crore during April-August, 1997 — the government intends to issue oil bonds (on same lines as recapitalisation bonds to banks) to the oil companies. Since the bonds proposed to be issued are worth only Rs 18,000 crore, it is not clear as to how it will tackle the balance deficit of Rs 2000 crore.

The bonds which will be of 5-7 years' maturity and carry interest of 10.5 per cent are not tradeable. Consequently, oil companies cannot sell these to generate cash. Even if sale was allowed, it would not have been an easy task either as the market for government bond/securities has not yet fully developed.

The oil companies cannot even pledge the bonds to banks and take loans; this is restricted to only Rs 5000 crore. They will thus, continue, to be under severe liquidity strain apart from suffering loss to the extent of differential between the market rate — this is 12.5 per cent and above — on the one hand, and 10.5 per cent available on oil bonds on the other.

Contrary to the impression that the government has reconciled itself to meeting accumulated deficit in the OPA from its pocket, the truth is that even the burden for this will fall on users of PoL products. The redemption of the bonds as well as the interest liabilities will be met out of the surplus it proposes to generate in the OPA by continuously raising the prices.

While the petroleum people may feel elated that the peace has finally arrived and that henceforth, there are better days ahead for the OPA and oil companies, the package adopted is neither viable, nor sustainable. This is because the government has not simply bothered to even look into the causes leading to high deficit in the OPA and has instead, sought to load the entire burden of correction on the hapless users of PoL products.

The year 1996-97 started with a deficit of Rs 5700 crore as on April 1, 1996. This was projected to increase to Rs 11,700 crore by March 1997. W e f July 3, 1996, an increase of 30 per cent in the prices of majority of petroleum products was announced to yield a saving of about Rs 9,700 crore. A little later, in a bid to calm down strong public resentment, the hike in diesel price was reduced to 15 per cent. With this, the expected saving was about Rs 7700 crore, leading to year-end deficit of Rs 4,000 crore.

All this made sense. However, the problem started after about five months later i e, end-November 1996 when the government suddenly talked of a deficit of Rs 15,500 crore by March 31, 1997 as against Rs 4000 crore hoped at the time of price hike in July, 1996. Sensing that it would not be easy to explain the massive increase of Rs 11,500 crore, it sought to revise the post-hike deficit to Rs 9700 crore.

The only viable and sustainable solution to the problem of deficit is to make the transactions in the OPA transparent to let people know as to which factor has contributed to the overall increase and by how much. The package of measures to reduce deficit should be evolved on this basis alone.

For the accumulated deficit the government should really return the money to OPA/oil companies instead of resorting to financial engineering. To deal with the incremental deficit, there is need to reduce custom and excise duty on crude and PoL products and reverse the recent decision on increasing royalty