Editorial

5 June, 1998

THE HINDU BUSINESS LINE

New gas pricing regime

Users losers, bonanza for GAIL

The increasing emphasis on the use of gas in power generation and the neglect of fertilisers has been a serious distortion, contrary to economic interests. The linkage of gas price to fuel oil/LSHS, which is essentially a heating fuel, has tacitly sought to perpetuate this trend, but the losers are the customers, says Uttam Gupta.

THE structure of gas pricing which came into effect from October 1, 1997 has some serious anomalies. The basic price to the consumers of onshore gas and offshore gas at landfall point (hereafter referred to as onshore/landfall) was fixed at Rs. 2,150 per thousand cu.m. linked to calorific value (CV) of 10,000 K.cal. To users in the North-East, this was concessional at Rs. 1,200 per thousand cu.m.

The price was fixed at 55 per cent of the cost of a basket of internationally traded fuels. While this was for the period from October 1, 1997 to March 31, 1998, for 1998-99, this would be 65 per cent and for 1999-2000, 75 per cent. From 2000- 01, the Government will examine the possibility of establishing linkage at 100 per cent.

Of the basic price, Rs. 1,800 per thousand cu.m. was the price to the producer — that is, ONGC, which accounts for the bulk of total gas supply. The contribution to the Gas Pool Account (GPA) was Rs. 350 per thousand cu.m. OIL got Rs. 1,900 per thousand cu.m. on supplies to users in the North- East.

The excess price to OIL over realisation from sale at lower price — that is, Rs. 1,200 per thousand cu.m., is cross-subsidised from the surplus on sale of gas produced by ONGC. The private producers of gas, for example, Enron/ Reliance, who are assured of a much higher market-driven price, are also subsidised from the pool.

A royalty of 10 per cent and central sales tax (CST) of 4 per cent — levied on the producer price — was about Rs. 259 per thousand cu.m. Plants along the HBJ pipeline paid transport charge of Rs. 1,150 per thousand cu.m. linked to CV of 8,500 K.cal — up from Rs. 850 per thousand cu.m. prior to October 1, 1997.

Invariably, users of on-shore/landfall gas get it at CV of about 9,000 K.Cal; those along HBJ at about 8,500 K.cal. The latter is lower primarily because of LPG extraction facilities owned by GAIL. In view of this, the system allowed for rebate to onshore/landfall plants as per formula (2150 + 259) x (10,000 - 9,000/ 10,000 or Rs. 241 per thousand cu.m. and to plants along HBJ as per formula 2150 x (10,000 - 8,500)/10,000 + 259 x (10,000 - 9,000)/10,000 or about Rs. 348 per thousand cu.m.

Following the principle of linkage to the cost of fuels, the basic price of gas has been raised to Rs. 2,411 per thousand cu.m. The concessional price to users in the North-East is hiked to Rs. 1,315 per thousand cu.m. Concurrently, the price to ONGC/OIL, the producer, has been increased to Rs. 2,003 per thousand cu.m. The contribution to GPA is now Rs. 408 per thousand cu.m. Royalty and CST on enhanced producer price is Rs. 288 per thousand cu.m.

Prior to October 1, 1997, based on the Kelkar Committee formula, the consumer price was linked to the cost of imported fuel oil. In view of this, there is no change fundamentally except that fuel oil is now substituted by a basket of fuels.

The price linkage to fuel costs is seriously flawed. Natural gas is not a replacement for fuels such as fuel oil, LSHS and so on. While the latter are used primarily for heating, natural gas is recognised mainly for its chemical value, and is ideal for use in chemical/petrochemical industries, including fertilisers. Between fertilisers and petrochemicals there is, in fact, complementarity, as the latter use mainly higher hydrocarbons — C2, C3, and so on, of gas — while the former use a lighter fraction — methane or CH4.

In the US, under the Natural Gas Policy Act (NGPA), the use of gas in power generation — mainly for heating — ranks ninth in a scale of 1-10. Fertilisers, chemical/petrochemicals rank second, next only to essential services such as hospitals. The use of gas in power for base load is prohibited. Moreover, in a situation of availability shortfall, cuts are applied from bottom up — the axe would fall on power first.

In India, the priorities for natural gas use were laid down by two high power committees — Lovraj Kumar (1976) and Satish Chandran (1979). According to them, the use of gas in the manufacture of fertilisers received top priority as it maximises national economic benefit and helps in increasing foodgrains production. Thus, until the end-1980s, the bulk of gas supplies went to fertilisers, with power receiving only the surplus.

The increasing emphasis on the use of gas in power generation — in the 1990s — to the neglect of fertilisers has been a serious distortion of these priorities and contrary to the national economic interest. The linkage of gas price to fuel oil/LSHS, which is essentially a heating fuel, has tacitly sought to perpetuate this trend. In recent years, the increasing shortage of gas has not prevented its use.

Ironically, when the gas price was increased from January 1, it would appear that even the linkage principle was not honoured. The ex-refinery prices of domestic fuel oil and LSHS were reduced (from January 16) — the former from Rs. 5,142.52 per KL to Rs. 5,053.43 per KL, and the latter from Rs. 6,089.16 per tonne to Rs. 5,452.18 per tonne.

Under the restructured system of hydrocarbon pricing (from September 2, 1997), the ex-refinery prices of fuel oil/LSHS are linked to their respective import parity price (IMPP). In view of this, and since the former have been reduced, the latter would clearly have gone down. Fuel oil/LSHS must be important components of the fuel basket — though not explicitly stated — to which gas price is linked. Therefore, there was a strong case for the price reduction.

The rebate to plants along the HBJ because of the shortfall in CV is given as per the formula: 2411 x (10,000 - 8,500)/10,000 + 288 x (10,000 - 9,000)/10,000 or Rs. 390 per thousand cu.m. In this, the rebate on royalty and CST, that is, Rs. 288 per thousand cu.m., is computed on the shortfall of 1,000 CV, even though the actual shortfall is 1,500 CV. Thus, any shortfall to the extent of 500 K.cal is disallowed. This works out to about Rs. 14.4 per thousand cu.m. (288 x 500/10,000).

The loss to the plant on account of a shortfall in CV is on the delivered cost of gas at factory tap; which alone should be used for working out the compensation. Against this, the users are recompensed only on the consumer price plus royalty/CST. This leaves out the transport charge — that is, Rs. 1,150 per thousand cu.m. On a CV shortfall of 1,500 K.cal, the consequential loss on this account would be about Rs. 172.5 per thousand cu.m. (1150 x 1500/10,000).

The Government has invented an ingenuous way of not having to pay rebate on the transport charge by linking it to CV of 8,500 K.cal. As the actual supply of gas to HBJ plants is at a CV of 8,500 K.cal and the benchmark level for transport is also the same, there would be no shortfall and, hence, no apparent justification for paying rebate.

But why should the transport charge be linked to 8,500 K.cal? What is the rationale? Why not link it to 10,000 K.cal to which the basic consumer price and producer price is linked? After all, it is illogical to differentiate on the same gas, one in regard to the consumer/ producer price and another in regard to the transport charge.

GAIL getting away without having to pay rebate is all the more reprehensible, especially when a significant loss of CV — about 500 K.cal — occurs on account of the LPG extraction facilities along the HBJ, of which it is the beneficiary. Even if it supplies gas at CV of above 8,500 K.cal — less likely — the user will have to pay a premium in proportion to the excess. This is a clear-cut case of GAIL having the cake and eating it too.

The total loss to user industries on account of under- payment towards rebate on CST/royalty and transport charge is about Rs. 187.0 per thousand cu.m. This translates to about Rs. 22 per million K.cal. Taking that about 6.2 million K.cal is needed to produce a tonne of urea, its production cost would be higher by Rs. 137 per tonne, to be reimbursed as additional subsidy under the retention pricing scheme (RPS).

There are eight fertiliser plants along HBJ — Indo Gulf Jagdishpur, IFFCO Aonla (2 units), NFL Vijaipur (2 units), Chambal Fertilisers Kota, Tata Chemicals Babrela and Oswal Chemicals Shahajahanpur — each with an annual production of 7.7 lakh tonnes, aggregating 6.16 million tonnes. Thus, the exchequer would be paying an extra subsidy of about Rs. 85 crores per annum, of which GAIL is the prime beneficiary.

GAIL has also been unjustifiably given a steep increase in transport charge. Even the existing level of Rs. 850 per thousand cu.m. was artificially inflated. The JPC, in fact, pointed out various aberrations — depreciation of pipeline taken as 10 years against 25, the international practice, for instance. It suggested a reasonable charge of about Rs. 466.4 per thousand cu.m. for an average distance of 1,060 km for fertiliser plants along HBJ.

Under the arrangement for payment sharing made by gas users to GAIL, the authorised sole seller, ONGC is paid on a residual basis, that is, after all other liabilities — GAIL's marketing margin, differential payments to private producers of gas, reimbursement to OIL on concessional sales to the North-East and so on — have been fully met.

In view of this, the entire burden of rebate for shortfall in CV falls on the ONGC. This is inequitable and discriminatory as of the total price paid by users, a significant share goes to the GoI/State governments and GAIL as royalty, CST, transport charge and sales tax.

In all fairness, liability towards rebate on ONGC should only be to the extent of producer price — that is, Rs. 2,003 per thousand cu.m. calculated on a shortfall of 1,000 K.cal; because CV at the Hazira terminal where GAIL picks up gas is 9,000 K.cal. This works out to Rs. 200.30 per thousand cu.m. The corresponding rebate on royalty/CST — Rs. 288 per thousand cu.m., is Rs. 28.80 per thousand cu.m. This should be borne by GoI/state government.

In respect of a further shortfall of 500 K.cal, GAIL being the beneficiary, the rebate on producer price should be met by it. This works out to about Rs. 100.15 per thousand cu.m. It should also pay the corresponding rebate on royalty/CST, that is, Rs. 14.4 per thousand cu.m. Needless to say, GAIL should pay a rebate of Rs. 172.5 per thousand cu.m. on transport charge.

On the contribution to GPA of Rs. 408 per thousand cu.m., the rebate is borne by ONGC. This is patently unjustified and a clear-cut case of GPA benefiting at the expense of ONGC. The rebate amount works out to about Rs. 61 per thousand cu.m. which should come from the Pool.

The anomalies in the existing system need to be urgently corrected by (i) allowing rebate to users to the full extent of shortfall in CV computed on the delivered price at the factory tap (ii) sharing the rebate burden between various beneficiaries — ONGC, GAIL, GoI, and the State governments — in proportion to their respective benefits (iii) avoiding linkage to fuels and fixing the price of gas on the basis of the reasonable production cost in line with the JPC recommendation and (iv) bringing down the transport charge to reasonable levels, again as suggested by the JPC.

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