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OIL & GAS SECTOR

Reforms still in the pipeline

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The recent rise in the international price of crude oil (on a downswing now) had led to a huge increase in under-recoveries of public sector oil companies as they have not been allowed to increase the selling price of petroleum products.

The administered price mechanism (APM) for petroleum products was dismantled in April 2002. The oil PSUs were permitted to fix the prices of petrol and diesel at their respective import parity price (IMPP). The prices of naphtha, fuel oil and LSHS were freed much earlier, that is, in April 1998. For kerosene and LPG, the Government had proposed to make the subsidy transparent by providing it directly from the Union Budget (before April 2002, oil companies were charging more on sale of other products such as naphtha, fuel oil, and ATF to cross-subsidise their sale). Even this was to be gradually phased out.

MAJOR RESTRUCTURING

In respect of natural gas, the Government had announced a major restructuring of its pricing beginning 1997. It proposed to link the gas price to the IMPP of a basket of internationally traded fuel oils at 55 per cent to begin with and gradually increasing the linkage to 100 per cent. By 2002, the pricing of gas was to be completely decontrolled. Five years later, the market-based pricing is nowhere in sight. Even the principles of pricing enunciated for the transitional phase (fixed subsidy for kerosene and LPG and linkage of gas price to IMPP of fuel oils) have not been followed.

The Government's sole concern appears to be to "completely immunise" the consumers from increasing international prices, though the country's dependence on crude imports is nearly 80 per cent of the requirement and is increasing rapidly.

In the case of gas too, major consumers (power and fertilisers) continue to pay nearly a fourth of the price of gas in major gas consuming countries and 40-50 per cent of the price at which imported LNG (liquefied natural gas) is sold in India. This is despite the demand for gas far outstripping its domestic supply.

UNSUSTAINABLE PRICE REGIME

The current pricing regime for petroleum products is unsustainable. The proceeds from the sale of these products fall far short of their respective cost of supply. This has led to huge under-recoveries, which was Rs 45,400 crore during 2005-06 and is estimated to be Rs 72,000 crore during 2006-07.

During 2005-06, upstream companies (primarily ONGC) absorbed Rs 14,000 crore by offering discount on sale of domestic crude to oil PSUs whereas, the Centre issued bonds worth Rs 11,500 crore. During 2006-07, these supports are expected to be Rs 24,000 crore and Rs 28,000 crore respectively.

The issue of bonds adds to Government's borrowings stock and, hence, the fiscal deficit. That there is no cash outflow for the present is no consolation. The issue of bonds on an unprecedented scale (Rs 40,000 crore in two years) could cause a serious cash crunch in the not-too-distant future.

It is well known that apart from the global supply-related factors, the huge increase in the demand for petro-products from China and India has contributed to the spurt in the international crude price.

The need of the hour is to conserve oil so that the import demand is reduced — without compromising on growth — to enable a reduction in international prices. However, this can happen only if the Government allows retail prices to reflect rising cost.

WRONG SIGNALS

The current dispensation is sending wrong signals to the oil companies as well. There is no pressure on them to innovate and improve efficiencies and to reduce their cost of operations. They know that the under-recoveries would get covered by bonds and government-directed discounts from upstream companies.

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And, in respect of any amount remaining uncovered by such support, they can conveniently pass the buck on to the government for not allowing them the freedom in fixing prices charged from the consumers.

The difference between the IMPP of a product and its selling price is identified with under-recovery. Truly speaking, for working out the under-recovery, one should take the cost of production and distribution, which need not be the same as the IMPP. In the case of oil PSUs having their own refineries that process imported crude (or domestic crude procured at IMPP), the cost is invariably lower than the IMPP.

This is because, unlike the IMPP that includes the Customs duty and port charges on landed price of finished product, in the case of domestic production, these levies/charges are paid only on raw material, that is, crude oil. Besides, the finished products attract a higher rate of Customs duty than the duty on import of crude.

MORE IMPACT

In an escalating price environment, the absolute impact of these differentials increases. This contributes to phenomenal margins enjoyed by the refineries, be it in the public or the private sector. For PSU oil retailers with their own refineries, this unjustifiably inflates their claims of under-recoveries.

Some oil PSU managements have come up with innovative ideas — including diversification of operations — to address their financial imbalances. The present regime of controls is not conducive to their execution.

The regime also leads to dissatisfaction amongst private oil companies who are forced to match the price on sales by oil PSUs. This is because the Government does not compensate the former for the consequential under-recoveries suffered by them.

The anomalous situation has led private players to suspend sales and further development of their retail outlets. Competition in oil retailing is urgently needed to deliver the best to the consumers. But the current pricing regime does not permit this! The subsisting arrangements have deflected attention from introspecting on whether the subsidy on LPG and kerosene are at all warranted. It is well known that almost the entire subsidy on LPG benefits the middle/upper-middle classes. Even the Dr Rangarajan Committee recommended its abolition. Umpteen studies have shown that a huge portion of subsidised kerosene is diverted for mixing with diesel and benefits largely the trading/business community. Here again, the Rangarajan Committee has recommended restricting subsidy to those below the poverty line.

FUEL OF THE FUTURE

Gas is the fuel of the future. Apart from meeting a major portion of the projected increase in energy demand, it has to replace oil to the extent possible. Therefore, proper pricing of gas is of paramount importance to send the right signals for ensuring efficient/optimum use on one hand and giving right incentives to producers/suppliers on the other. The present pricing regime is far from conducive to achieving these goals.

The Ministry of Petroleum and Natural Gas (MPNG) is keen that the price of domestic gas — flowing from fields operated by private sector — should be determined by competitive bidding.

Why should the same principle not be applied to all gas supplies irrespective of whether the gas is supplied from an old or a new field, whether under public control or private control? And, why should pricing be guided by sectoral/regional preferences?

Supply of energy at a reasonable price could be a major bottleneck in the efforts to maintain economic growth at a high rate. Undoubtedly, there is a huge untapped potential for both oil and gas. But, with the present price regime, it is next to impossible to tap the potential.

The need of the hour is to liberate both oil and gas from the clutches of price controls — as decided already several years back — and allow the market forces to take the lead. As regards the poor/people below the poverty line, the Government must switch over to the concept of direct income support.

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