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## Robbing Peter to pay Paul

Price hikes will spell doom for the user industries and consumers of petroleum products, says Uttam Gupta

**T**HE debate over the market determined pricing mechanism (MDPM) in petroleum products has taken a new twist.

The requirements of investment in exploration, production, refining and marketing to meet the projected demand of POL by the year 2010 has been estimated at a staggering Rs 5,00,000 crore approximately.

The votaries of the MDPM argue that the present administered pricing mechanism (APM) is sub-optimal and is not conducive to generation of the required resources. Whether or not the APM allows for reasonable return on investments should be ascertained in terms of the underlying facts and cannot be left to the interpretation of the suppliers which may be biased.

Not much is known about the return element included in fixing the retention margins allowed to the refineries. In respect of natural gas, the government allows 15 per cent post-tax return on networth in fixing the producers' price. It can be safely assumed that a similar return on other hydrocarbon feedstocks supplied by oil companies.

Besides, the methodology of cost computations — particularly recognition of various elements of fixed cost, including capital servicing charges on actuals and normative production levels — allow for increasing return actually earned by the oil companies.

In regard to variable cost, the weighted average of the cost of imported and indigenous crude is reportedly taken as the basis. Considering that the former is significantly higher than the latter, slight change of the mix (lowering of the import component) could result in windfall profits.

Given the lack of transparency in the pricing of petroleum products, hidden cushions in different areas of costing which, in turn, give scope for enhancing profitability over and above the stipulated levels cannot be ruled out.

Over and above the internal resources of the oil companies, the government has instituted various mechanisms aimed at collecting resources from the users of petroleum products, specifically with the intention of supporting developmental activity in the oil sector. The Oil Pool Account (OPA) is one such mechanism where the excess of the realisation

at administered selling prices over the retention margin allowed to the oil companies are credited.

Until the end of the 80s, the OPA had, in fact, a cumulative surplus of about Rs 9000 crore. Thereafter, in the early 90s, it has reported some deficit which sounds quite illogical, particularly in view of the incessant increase in the selling prices of petroleum products on the one hand and continuing low price of imported crude oil on the other.

An explanation reportedly offered by the ministry of petroleum is the increase in the price of indigenous

prevents the government from utilising these funds for supporting capital expenditure in the oil sector.

In the gas sector, there is the Gas Pool Account (GPA). Initially fixed at Rs 50 per thousand cubic metre of gas, this represents the excess of the price paid by the consumers over the price allowed to the producers. This has since increased to Rs 350 per thousand cubic metre. Accruals in the GPA are meant for supporting exploration and development activity in the gas sector.

In view of the above, the impression that the APR does not lend itself to

the general budgetary needs. Likewise, the cumulative accruals of about Rs 9000 crore in the OPA until the end of 80s, were used for reducing the overall budgetary deficit.

So far, the government has used the PSUs in the petroleum sector as a milch cow for supporting its fiscal profligacy. Recourse to the new-found MDPM mantra is another means to continue in its profligate ways. The MDPM will give the government-owned oil companies unfettered right to raise prices at will. This is because they have virtual monopoly in production, marketing and distribution of POL. Private sector refineries currently under implementation will just not be able to offer any meaningful competition due to much higher capital cost due to inflation.

Contemplated moves like the customs duty on imported naphtha will ensure that even the cost of imports is brought up to the level at which the domestic companies would like to sell their product. Hence, the possibility of cheaper imports coming in the way of the oil sector charging higher prices is also ruled out.

Price hikes under the MDPM will spell doom for the user industries and consumers of petroleum products, particularly the poor. The Sundarajan Committee has suggested budgetary support for those who cannot afford to pay higher prices. The problem is that direct subsidisation is not only highly inflationary but is also ineffective and prone to widespread misuse. Considering the critical importance of the oil and gas sectors to the national economy, the idea of deregulating them should be dropped.

There is, however, need for tightening various nuts and bolts in the existing APR and making its operation transparent to ensure that the prices to the users are reasonable while, at the same time, giving a fair return to the oil companies.

The need for improving fiscal discipline cannot be overemphasised. This is a prerequisite to prevent unwarranted encumbrances on the resources that can and must be available to the oil companies for supporting development of the petroleum sector.

Simultaneously, the government should pursue restructuring of the PSUs through significant disinvestment of its equity holding and giving their managements requisite autonomy.

crude allowed to the ONGC and OIL and the impact of higher taxes and duties. The consequential loss on this account is only notional as, to this extent, profit of ONGC and OIL both owned by none other than the government itself besides additional tax accruals to the exchequer, would have increased.

Since 1974, the government has been collecting cess on the production of crude oil amounting to a hefty Rs 20,000 crore as of March 31, 1995. This fund is meant for development of the oil and petroleum sector. Another source of huge revenue is customs duty on imported crude assessed at 35 per cent ad valorem. Although customarily treated as part of the overall tax revenue, nothing

the possibility of raising adequate resources is a myth. On the contrary, frequent and steep increase in the administered prices of various petroleum products during the 80s and early 90s has proliferated the oil sector's resources at the expense of the user industries.

Inexplicably, the massive resources garnered in various ways are not redeployed for the purposes they are meant for. Of the Rs 20,000 crore collected through the cess on crude oil, only Rs 902 crore i.e. a measly 4.5 per cent, found their way back to the Oil Industry Development Board (OIDB) for funding exploration, development, refining and marketing programmes. Obviously, the rest have been used almost entirely for meeting

