Clearing the cobwebs in gas pricing

The serious anomalies in the pricing of gas should be solved by evolving proper norms keeping in view the broader national perspective, says Uttam Gupta

BASED on the recommendations of the Kelkar committee, the increase in gas prices has come into effect from 1st January, 1992. The widespread and spontaneous protest from the user industries has died down. However, the trail of debilitating effect on them and in fact, the entire economy, calls for an objective appraisal of the legitimacy or otherwise of the decision. A brief recapitulation of how gas pricing was done in the past will help straighten out the issues.

Before January, 1987, the prices of natural gas had been fixed in an "ad hoc" manner from time to time largely by gas producing companies themselves. With gas becoming available on a large scale, particularly from the Bombay High/South Bassein region, the Government entrusted the task of evolving a policy on natural gas prices to a high level committee. Based on the committee's recommendations, suitable proposals were considered by a committee of secretaries and subsequently by a group of ministers during the period 1984-86. The approach suggested was to set the level of prices in a manner that there is a parity between them and the prices of fuel/feedstock which is sought to be replaced in power and fertilsier sectors. For the producers, the proposal was to allow prices on the basis of the cost of production of free gas from the South Bassein and the cost of transportation along the HBJ pipeline. In short, it was the principle of "equivalence" mooted for fixing the price to the user industries and the cost of production as the basis for determining producers' realisation.

The Government, however, did not accept the basis suggested by the group of ministers. Indeed, the prices finally approved in January, 1987, were entirely on the basis of cost of production and there was no distinction proposed between the prices payable by the consumers and the price paid to the producer. For gas at landfall point and for on-shore gas, this was fixed at Rs 1400 per 1000 cubic metre and Rs 2250 per 1000 cubic metre for gas supplied along the HBJ pipeline. Considering that there is 14 per cent royalty and central sales tax and local tax to be paid, to a user industry, the actual cost is much more than the figures indicated. The GSFC-Baroda plant for instance, which gets on-shore gas would thus have to pay about Rs 1743 per 1000 cubic metre. At this level, the increase effected from 1.2.1987 was almost 500 per cent over Rs 310 per 1000 cubic metre being paid by the plant earlier. These prices were to remain in force until such time a fresh review of gas pricing was completed.

The Kelkar Committee recommended an increase of Rs 200 per 1000 cubic metre per annum over a period of three consecutive years. In doing so, it adopted the fuel oil equivalent of domestic natural gas which was estimated at about Rs 2000 per 1000 cubic metre at the landfall point. This may sound like a significant change in the thrust of policy. However, the suggested package had no intention of abandoning the cost plus formula. The Committee sought to ensure that at the price level of Rs 1500 per 1000 cubic metre recommended by it for the producer, not only the cost of production of gas is fully recovered, but also, a return of 25 per cent pre-tax (corresponding to 15 per cent post-tax) is also ensured. This is against 12 per cent supposed to be given to fertilisers, which in actual practice is not available. Which ever principle is adopted, the message was loud and clear i.e. the prices which had already been raised to a hefty 6 times should be increased still further.

Interestingly, the Department of Petroleum and Natural Gas was not satisfied even with the increase suggested by the Kelkar Committee. Indeed, it wanted the gas prices to be raised by a whopping Rs 1100 per 1000 cubic metre and an increase of Rs 350 in the transportation charge over the level of Rs 850 per 1000 cubic metre existing then. In retrospect, the Department's high profile on the issue of gas price looks like a trojan horse that was used to ensure implementation of at least the increase that the Kelkar Committee had recommended in the face of all-round protest from the user industries. There is no objection to fixation of price in a manner that seeks to cover the cost of production and allow for a reasonable rate of return. But, what is important is that the basic parameters used for the computation of cost, need to be carefully evaluated to prevent artificial increase on the user industries. In this context, it is important to see whether the exercise is based on certain norms or it is just arbitrary. The cost data furnished in the Kelkar Committee report for the year 1987-88 brings out certain anomalies. The capital servicing charges on investment in the off-share area have been distributed over 6.335 billion cubic metre of gas. This quantity is much less than the gross production figure of 8.259 billion cubic metre as reported in the Indian Petroleum and Natural Gas Statistics (1989-90) for that year. To a considerable extent, the difference is on account of the gas quantity being flared. The implication is that the cost of a large part of investment is sought to be recovered from the users of gas to whom its benefit does not really accrue. Indeed, the user industries are even being made to pay for gas flaring.

Prices were to be fixed on the basis of cost of production in Bombay High

If these charges are re-worked using the gross production of gas at 8.259 billion cubic metre, the price on this basis alone should reduce by about Rs 167 per 1000 cubic metre. To the extent, fixed costs other than the capital servicing charges have also been computed on the basis of the net quantity of gas which is not clear from reading of the Kelkar Committee report, further reduction will accrue by computing cost on gross production of gas.

There are other anomalies as well. Investment on gas exploration and production which yield benefits only in the future are sought to be recovered by way of increase in the gas prices. Then, pricing is based only on the cost of production of gas from the off-shore area even though the individual user industries may be drawing gas from other sources particularly on-shore gas fields where the investment cost and consequently, the cost of supplying gas may be lower. In regard to the transportation charge which is currently Rs 850 per 1000 cubic metre to be paid by users along the HBJ pipeline, it turned out that provision for depreciation has been based on 10 years life of the pipeline as against an internationally accepted norm of 25 years and minimum life expectancy of 50 years. Strangely, for continuous process industry like fertilisers, the depreciation was extended from 10 years to 20 years and now reduced to 15 years.

Linking gas price to fuel oil equivalent is again an artifical/arbitrary basis. It assumes that the user industries are free to choose between alternate feedstock and that their supply is not a limitation. Do these assumptions hold, say in regard to fertiliser industry which is the predominant user of gas? The answer is a categorical "no". First, the feedstock policy is decided by the Government and even as per the recommendation of the Eighth Plan Working Group on Fertilisers, the highest priority is attached to use of gas as feedstock. Second, adequate quantities of even the alternate feedstocks such as naphtha and fuel oil are not available. In fact, currently out of a total of 8.2 million tonnes of nitrogen capacity, only 15 per cent is based on use of fuel oil. The Kelkar Committee has used the landed price of imported fuel oil in arriving at the equivalent gas price. It is significant to note that even the world over a meagre 3 per cent of total ammonia capacity is based on fuel oil. How can a feedstock which is not in use on any significant scale whether within the country or outside, can become the basis for pricing? Purely because these forms of hydrocarbons have become scarce and the user industries particularly, fertilisers, have no option but to adopt gas, it would be unfair to jack up the prices on that basis.

Fertilisers and power are the two major users of gas. Already, both the sectors had been reeling under the impact of the increase in gas prices effected last i.e. w.e.f 1st February, 1987. Their woes are even greater the moment one considers that they

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do not have the easy option of passing on the burden of consequential increase in cost of production to their consumers. In fertilisers, the selling price is controlled at a low level and unrelated to the cost of production through a statutory order. And, in power, bulk of it has to be supplied at subsidised rates, particularly to the agricultural sector. Faced with inflexible selling prices on the one hand and steep increases in the cost of various inputs including gas on the other, the quantum of subsidies in both these industries has increased leaps and bounds. In fertilisers, these are being paid directly from the exchequer. And, in power these manifest as huge losses of the State Electricity Boards (SEBs). For this very reason, both the sectors have drawn flak from the Government as well as international agencies including IMF and the World Bank.

The increase is most unfortunate at a time when the Government has taken on to itself certain onerous obligations. In August, 1991, a commitment was made to the IMF that fertiliser subsidy would be eliminated by the end of the year 1993-94. The Govt has also agreed to wipe out the losses currently being incurred by the power sector. Clearly, the decision to increase the gas price does not square up with these commitments. Well, the orthodox conventions may dictate that "let the ultimate consumer pay for the higher cost". But, in practice, the processes do not work that way.

For instance, can we ask the farmers to pay for the full cost based price of fertilisers which even at the prescribed efficiency norms decided by the government will be substantially higher than the present selling prices. Can we afford to ignore that 75 per cent of our farmers are small and marginal and a majority of them do not even have a marketable surplus? It is precisely these very compulsions which forced the government to a hasty retreat after initially announcing a hefty increase of 40 per cent in the selling price of fertilisers in July 1991. It had to remain content with an increase of only 30 per cent and with exemption for the small and marginal farmers. The factors involved here are not just political. The decisions had also to keep in view the purchasing power of the farmers as also the consumers of foodgrains.

Gas is an important national input. The policies with regard to its pricing and utilisation/distribution should therefore keep in view the broader national perspective. Fertilisers and power are as much of a priority industry on the national agenda as gas. In fact, it is important to recall that when the gas finds were beginning to become available, the Lovraj Kumar Committee categorically stated in 1976 that the national economy will derive the maximum economic advantage if it is to be used in production of fertilisers. This view was upheld subsequently by the Satish Chandran Committee on optimum utilisation of off-shore gas, that the opportunity cost of lean gas (after removal of C2, C3 and C4 fractions) would be maximum when it is used in production of nitrogenous fertilisers. Clearly, the development of gas production and distribution infrastructure including the laying of the HBJ pipeline has been orientated to meet the growing demand for this important feedstock in the fertiliser sector.

Now by pricing gas at an unrealistically high level, this fruitful interface so vital to the national endeavours is sought to be disturbed. In doing so, not only a grave danger is posed to the healthy growth of the fertiliser industry, even the exchequer is no better off in terms of resource availability. Because the farmer is not expected to take on the load of extra cost, the cost push resulting from increase in gas price has to be paid as additional subsidy. Indeed, there is a net loss to the exchequer. In this context, if the gas price is raised by Rs 100 per 1000 cubic metre, while the additional revenue to the GOI as owner of ONGC from this is about Rs 44 crores, the amount that is paid out as additional fertiliser subsidy is higher at Rs 55 crores. This extra Rs 11 crore actually goes to the kitty of the states which collect royalty and sales-tax etc., on ad valorem basis.

Unfortunately, we have been caught in a cob web. Subsidies on an increasing scale are considered unsustainable. The country cannot afford to decontrol fertilisers or even recklessly increase the power tariff rated for the agricultural sector. The only alternative available is to effectively tackle the cost push. This calls for a concerted national effort devoid of sectarianism. The need for pricing of gas on a reasonable basis has to be appreciated in this broader national framework. Just as there are prescribed stringent norms for determining retention prices for the fertiliser industry, there is no reason why proper norms should not be evolved even with regard to the pricing of gas. Simultaneously, certain degree of "transparency" and "accountability" is also necessary which is currently missing. The prices must be computed on the basis of the total production of the gas and not the net quantity. To the extent, there is additional investment cost on gas exploration and production which yield benefits only in the future, the same should come by way of independent support from the central plan outlay.