

WITH the constitution of a committee under the chairmanship of T.L. Shankar, Principal, Administrative Staff College of India (ASCI), Hyderabad, in January 1995, the Government has already set in motion a fresh exercise to review the existing pricing policy for natural gas. The present pricing dispensation which comes to an end on December 31, 1995, was introduced in January 1992, based on the recommendation of the Kelkar Committee (the report was submitted in 1991).

The Kelkar Committee wanted the selling price of gas to be fixed on the basis of fuel oil equivalent and suggested a price of Rs 2,000 per thousand cubic metre at the land fall point for offshore gas as well as for onshore gas. Considering that the prevailing price at that time was Rs 1,400 per thousand cubic metre (prior to 1.1.1992), the committee recommended that this target be reached in three stages with an increase of Rs 200 per thousand cubic metre each year.

The Government, however, enforced an increase of Rs 150 w.e.f. January 1, 1992, and thereafter Rs 100 each in the succeeding three years. Consequent to these revisions w.e.f. January 1, 1995, the price at the land fall point is Rs 1,850 per thousand cubic metre. While this is the price (excluding royalty, Central sales tax, sales tax and transport charge) that consumers pay, the producers' (ONGC and OIL) realisation is Rs 1,500 per thousand cubic metre. The excess of what the selling price over this i.e. Rs 350 per thousand cubic metre goes into the Gas Pool Account (GPA) which is meant for supporting exploration and development of gas fields.

The producer's price covers the cost of production at actuals and includes a profit margin of 25 per cent pre-tax. But, what is more important is that this price seeks to cover the cost of free gas from South Bassein area only. Being a recent vintage field, the investment in exploration and development is high which results in high capital servicing burden and consequently, higher price. But, this is not the case with majority of other gas fields including Bombay High. These supply bulks of the total gas production which is low cost in view of the much smaller investment initially as also the fact that much of this would have already been amortized.

Quite clearly, whereas on a weighted average basis, the overall cost of gas to the producers is substantially lower than Rs 1,500 per thousand cubic metre, charging the latter on the entire supplies inevitably results in unprecedented profit margins. The ever-smiling balance sheets of ONGC and OIL bear ample testimony to this reality.

What about the users of gas? They are made to pay not only for the inflated profits of producers, but also, for various other costs for which the benefit does not accrue to them. Investment related charges and other fixed cost elements are distributed over the 'net' production

Evolving a fair gas pricing policy

The Govt would do well to roll back the price of natural gas to the level prevailing as on January 1, 1992, and then bring about the necessary reduction based on the JPC recommendations, says *Uttam Gupta*

of gas which excludes flaring. In other words, the users are being made to pay for flaring.

The Government is spending a lot of money in exploration and development of new fields of which the benefit by way of flow of additional gas will accrue in future. But, such expenses too are built into the price charged to the present users on existing supplies. Contribution to the GPA further compounds the burden. Consider the charge for transporting gas through the HBJ pipeline. Presently, this is a uniform Rs 850 per thousand cubic metre irrespective of the distance. According to the JPC, reasonable charge should not be more than Rs 466.4.

A closer scrutiny brings to light some glaring anomalies. For normalising fixed cost including capital charges, a throughput of 18 million cubic metre of gas per day (mcmd) is assumed while the pipeline capacity is 33 mcmd. Besides, for computing depreciation, the life of the pipeline is taken as 10 years although the international practice is 25 years and the pipeline can be in use for as long as 50 years.

Even as the Shankar Committee goes about examining the issue de novo, the equivalence principle for charging the users still seems to be sticking. But, why? Is there any sound justification? The Kelkar Committee argued that fuel oil provides a substitute for gas and therefore, the latter's price should be linked to the former. This is seriously flawed.

In fact, all major plants that came up in 80s and early 90s, are based on gas. Each involves huge investment and plant and equipment are specifically dovetailed to the use of gas as feed and fuel. Even the infrastructure for gas supply including the HBJ pipeline, was developed primarily to serve fertiliser plants.

Now, by stressing replacement with fuel oil or naphtha, are we telling them that they should switchover to these fuels? Any attempt to do so will knock at the very existence / viability of these plants. Already, much against the laid-down policy, gas supplies for steam generation and captive power have been denied. The plants are being forced to use alternate fuels which cost more (due to higher price and lower conversion efficiency) and will affect reliability of operations in the long-run. Asking them to a switch over even in respect of feed in the process plant, will be catastrophic.

Another point we must consider is whether these alternate fuels are available in the desired quantities? Presently, the industry uses about 7.5 billion cubic metre of gas per annum. Replacement of this to yield equivalent energy will



Gas pricing is a national issue and is linked to the country's food security

require about 6.4 million tonnes of naphtha. Can the oil sector supply the required quantity? Supplies through imports and that too on a continuous and uninterrupted basis are not easy to get in view of the problems of foreign exchange, infrastructural constraints at ports and internal transportation.

Notwithstanding the above, if the gas is priced on say, naphtha equivalent and taking US \$ 170 per tonne or about Rs 5,800 (US \$ 1 = 34), as its C&F landed cost, the gas price will have to be about Rs 5,000 per thousand cubic metre at landfall point. If fuel oil is taken as the basis, at prevailing US \$ 106 per tonne or Rs 3,604 per tonne, the gas price will be about Rs 3,300 per thousand cubic metre.

With the existing price being Rs 1,850, the increase will be Rs 1,450 if

fuel oil is used as the basis and Rs 3,150 if naphtha is adopted. Resultant increase in the cost of production of urea will be about Rs 1,000 per tonne in the former case and about Rs 2,200 per tonne in the latter. Under the RPS, this will correspondingly result in increased subsidy. The actual impact will be much more on account of consequential increase in royalty, CST and sales tax which are all levied on ad valorem basis.

Needless to mention that every time the fertiliser subsidy bill increases (no matter how it is caused), it leads to adverse policy reorientations apart from inadequate Budget allocations causing serious financial problems for the industry and even a threat to its continued viability.

Increase in gas price will play an even greater havoc in case urea is decontrolled as in that event, the Government will not pay subsidy. Already, on a weighted average basis, the cost of supplying urea from gas-based plants is about Rs 5,500 per tonne against the present selling price of Rs 3,320 per tonne i.e. a gap of about Rs 2,200 per tonne. This will increase further following hike in gas price. And, all this will have to be borne by farmers in

the decontrolled regime. Can they afford it?

Going by the experience of phosphate, the answer is a categorical 'no'. Farmers use fertiliser for growing food, which, even the rich would wish to have cheap; for majority of the poor, it has to be that way only. How can the farmer buy highly priced inputs and, yet, sell their produce cheap?

Gas pricing is a national issue. It is linked to the country's food security for which the nation has toiled hard in the last two-and-half decades (ending 80s). Any attempt to raise it by using an artificial basis can seriously jeopardise the country's food security by leading to decline in fertiliser consumption, increasing the cost of food and decline in foodgrains production.

Gas producers should also recognise that if the fertiliser industry (the predominant user of gas) is rendered unviable because it cannot afford higher price of gas, it will not be in the former's interest either. Where will the producers sell the resultant surplus gas? There is a heavy responsibility on the Shankar Committee. In evolving the new gas pricing policy, it should not ignore the users; particularly the fertiliser industry.

The generally accepted principle is that the basic inputs including feedstock should be made available to industries at the internationally competitive prices. Why not apply this logic in regard to gas? After all, is not the Indian industry called upon to come up with cost comparable to urea coming from the Middle East or Russia. Then, why not charge our plants the same price as in those countries?

Alternatively, the gas may be priced on its own based on "reasonable" cost of production and distribution. In fact, the JPC recommended this approach in August 1992. Specifically, the JPC wanted a reduction in gas price by 35 per cent, removal of Central royalty and fixation of transport charge in a reasonable and realistic manner. The Government promised on the floor of Parliament that all JPC recommendations including those relating to gas pricing will be implemented in toto. Far from that, gas prices were increased with impunity ignoring the JPC.

The Government would do well to roll back the price of natural gas to the level prevailing as on January 1, 1992, and thereafter bring about the necessary reduction based on the JPC recommendations as only then will it be possible to reduce the subsidy burden on the exchequer, prevent hike in fertiliser price to the farmers and in the ultimate analysis, save this critical industry from impending extinction.

The author is Chief Economist at the FAI