THE OBSERVER
OF BUSINESS AND POLITICS

MONDAY JUNE 5, 1995

Passing on the buck

The present arrangements for pricing and distribution of POL should continue, says **Uttam Gupta**

THE market determined pricing mechanism (MDPM) for petroleum products (POL) recommended by the Sundarajan committee and now high on the agenda of the Restructuring Group, has stirred a hornet's nest. While, on the one hand, it has raised a number of questions about the existing arrangements, specifically the administered pricing regime, on the other, it has created a flutter amongst user industries and consumers who fear steep increase in prices of POL.

The selling prices of various petroleum products are fixed by the government keeping in mind the end use. Kerosene, a mass consumption item, is priced low whereas petrol, naphtha, fuel oil, LSHS, motor spirit and aviation turbine fuel (ATF) are priced high as these represent the upper segment of demand. However, naphtha, fuel oil, LSHS are supplied to the fertiliser industry at low prices.

Whereas the consumers/user industries pay at the prescribed rates, the retention margins of the refineries are independently determined according to some formula, known only to the concerned authorities i.e. the Oil Coordination Committee (OCC) which fixes prices and administers the Oil Pool Account. In fixing the retention prices, the oil companies are entitled to a return of 12 per cent post tax on net worth. The precise method of computation of these prices — how various items of expenditure, particularly capital cost, are computed and what are the norms, if any, with regard to capacity utilisation, are highly critical factors. Even the slightest change in these parameters can lead to substantial swings in the retention margins, the consequences of which must necessarily by borne by users. Considering that there is no transparency in these exercises, anything can pass muster.

The difference between the realisation from sales at administered prices and the ex-refinery prices on the other is credited/debited to the OPA. The price fixation for all products put together is such that it would invariably generate a positive balance in the account.

At the beginning of 90s, there was a cumulative surplus of about Rs 9,000 crore in the OPA caused by the decline in the international prices of crude oil and increase in selling prices of POL. In respect of indigenous supplies of crude, in any case, a substantially lower cost — about Rs 1,800 per tonne — was being allowed to the ONGC and OIL (the actual cost of production incurred by the latter being still less). These funds were unfortunately appropriated by the Government of India as capital receipts and used for reducing its overall fiscal deficit.

At the end of 1994-95, the OPA is reportedly showing a cumulative deficit of about Rs 5,000 crore. This is intriguing as there is no fundamental change to warrant emergence of such an unprecedented level of deficit. Although, during 1990-91, the prices of imported crude oil and POL increased, thereafter, these have shown a trend of decline. Moreover, the government raised the selling prices of POL on three occasions — October 1990, July 1991 and September 1992.

Instead of an objective introspection, the Rs 5,000 crore deficit in the OPA is being considered as sacrosanct. In the context of scrapping of administered pricing regime, further increase in prices of POL is being sought as the government has reportedly has no funds to support this deficit.

A ruthless inconsistency is obvious. Whenever there is a surplus in the OPA, the government quietly appropriates the same and when there is a deficit, the purported loss is sought to be recovered from the consumers.

While MDPM is being seriously pursued, we must ask a basic question — whether a market in POL exists in the real sense of the term. There are no competing suppliers who give the consumers a choice. There is a virtual monopoly of government-owned companies over POL. There are some private sector refineries, but their share is too small. The proposed introduction of MDPM will only be a change of name.

The Sundarajan committee report proposes to link all POL prices to international ones. Thus, the selling price of kerosene will be raised by Rs 3.50 per litre, LPG cylinders will cost an additional Rs 37. Naphtha, fuel oil, LSHS prices to fertiliser plants will be increased substantially from their existing level. The committee has however, argued that in case the government still wants to subsidise the users, it must do so directly and out of its own funds.

The prices of petrol, ATF, naphtha, fuel oil/LSHS for general industrial use which are already higher than the corresponding international levels will not be reduced simply because this category of users can afford to pay.

The existing administered pricing system is an integrated arrangement seeking to balance the interest of those who can't afford to pay with those who can. The OPA has not only been self-sustaining, but, also generating surplus as the excess realisation on sale of high segment products was more than paying for the loss, if any, on selling kerosene, LPG etc. at lower prices. The present problem with it is only due to extraneous factors.

Under the MDPM, whereas the subsidy responsibility is proposed to be transferred to the exchequer (kerosene alone will cost a whopping Rs 4,000 crore), the oil companies will land up creaming off supernormal profits for themselves.

The suggested modus operandi for administering the subsidy leads to serious doubts about its effectiveness. According to the committee, where the companies will sell to the dealers at the full price, the latter are expected to sell to the consumers at subsidised lower price and collect the differential from the concerned state governments.

Will the intended benefit reach consumers? Will the subsidy money be utilised properly and misuse prevented? Are the state machineries equipped to carry out such a gigantic task? The government should address these questions before deciding to subsidise directly from the budget.

The oil industry is well known for huge time and cost overruns in implementation of new projects. Recently, the Parliamentary Standing Committee on Petroleum pointed out a whopping cost overrun of about Rs 3,500 crore in executing some projects, including the Kandla-Bhatinda oil pipeline and the Neelam oil fields in Bombay High.

These could have been avoided through timely approval, proper planning and effective implementation. But, who cares?

The present day conditions are far from conducive to introduction of MDPM in POL. While on the one hand, there is lack of competition on the supply side, on the other, majority of the users do not have adequate purchasing power. Insistence on MDPM will do incalculable damage to the economy by exacerbating inflation, closure of a number of industries and by burdening the poor. Moreover, the fact that the entire exercise is being taken up in a non-transparent manner, makes matters worse.