The Cost of Reliance on Gas

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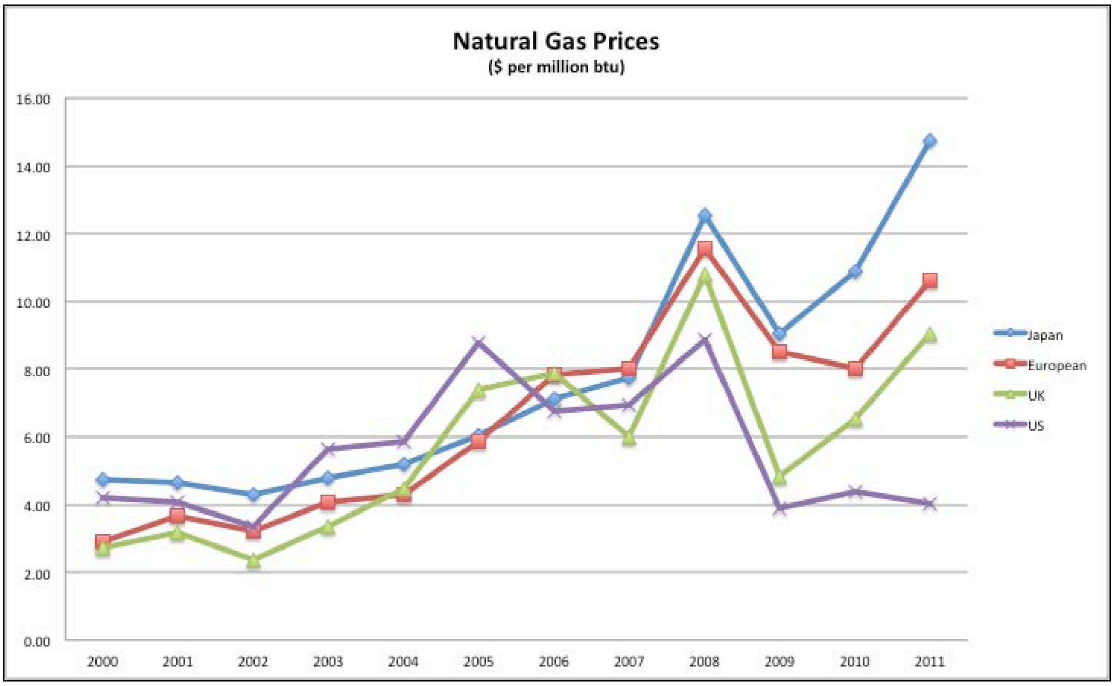

Amidst controversy, UPA II is once again working to boost private profit at the expense of ordinary citizens. This time it is doing so by opting to change the policy on pricing of natural gas, used principally to produce power and fertiliser and for the extraction of LPG. As of now there are multiple pricing regimes prevailing in India's gas market. The ones that matter most are the prices charged by the principal producers, consisting of the public sector Oil & Natural Gas Corporation Ltd (ONGC) and Oil India Limited (OIL) and the private sector Reliance Industries Limited (RIL). They, together, account for more than 85 per cent of the domestically extracted and delivered natural gas.

The prices charged by ONGC and OIL for much of the gas they sell are based on an administered pricing mechanism (APM), wherein prices are ostensibly calculated on a cost-plus basis. The price charged by RIL (of $4.2 per million British thermal units (mmBtu)), on the other hand, is an "arms length" price linked to the price of oil and arrived at in consultation with the government as per the terms of the New Exploration and Licensing Policy (NELP). As of now the price of APM gas varies from $2.52 to $4.2, while the price of non-APM gas varies from $4.2 to $ 5.25 per mmBtu.

In December 2012, one more of many official committees headed by C. Rangarajan, Advisor to the Prime Minister, recommended that India should shift over time to a single gas pricing formula for all forms of gas and all consuming sectors with domestic gas prices being determined on an "arms length" basis. Based on that recommendation and a version of the pricing formula suggested by the committee, the Petroleum and Natural Gas Ministry had reportedly moved a Cabinet note recently, recommending that the price of domestically produced gas be fixed at $6.7 per mmBtu, which amounts to a 60 per cent increase in the currently most prevalent non-APM price. This would benefit the public sector oil companies immediately, and Reliance Industries from April 2014.

The recommendation has stirred a controversy, because while it would deliver a bonanza to the current producers of natural gas in India, it would have damaging consequences for the user industries, which include the all important power and fertiliser sectors. According to one estimate, every dollar increase in the price of gas can impose a burden of as much as Rs. 3000-4000 crore a year (depending on production volume) on urea producers and as much as Rs. 10,000 crore on gas-based electricity generation units. Many of these units are in the public sector. Hence, much of the benefit that the public sector oil companies derive from a higher gas price will be wiped out by the high costs incurred by other public sector units or by the government burdened with a higher subsidy bill for fertiliser and power. If that is to be avoided, end-product prices would have to be raised substantially.

Not surprisingly, the fertiliser, power and finance ministries have reportedly objected to the proposal, forcing the cabinet to return the note for comments from the affected ministries. The major beneficiary would be private sector Reliance Industries, which has been facing trouble meeting its production target, and could gain much from the pricing bonanza that the proposal involves. Some other private sector producers, in whose case the price to be charged was written into the production-sharing contract, would not benefit. This has led up to the charge from opposition leaders tracking the proposal that the hike is expressly intended to benefit Reliance, at the expense of the citizen as consumer or taxpayer.

The government's obvious defence is that the proposal for a gas price hike is based on the recommendations of an 'expert committee' chaired by Rangarajan, which in turn has used the argument of arriving at an "arms length" to justify its pricing formula. The problem, of course, lies in identifying an arms length price, since the difficulties of transporting gas either through pipelines or as Liquefied Natural Gas (LNG) from which gas is extracted, has resulted in segmented global markets and therefore widely different pricing mechanisms. The Rangarajan formula is indeed opaque and convoluted. It wants the price in India to be an average of two prices: (i) "the volume-weighted netback price to producers at LNG exporting country well-head for Indian imports for the trailing 12 months", or the implicit price paid at source for natural gas imported by India; and (ii) the volume-weighted price of gas at the Henry Hub in the US and the National Balancing Point in the UK and the price implicit in the Japan Custom Cleared prices of LNG for the trailing 12 months.

Adopting this formula brings, among other elements, the price of gas in Japan into the determination of the domestic price in India. This is problematic since prices in Japan (see Chart) are among the highest in the world. On the other hand the US Henry Hub, identified as the most developed among global competitive gas pricing markets, has the lowest price. Further, Qatar is India's principal source of LNG import and Japan does not enter the picture. So the resort to the second of the pricing components in the formula detailed above, brings in prices from an irrelevant and more expensive market into the determination of the gas price in India. In fact, the Association of Power Producers (APP) has argued that the Japanese import price should be removed from the domestic price computation formula as Japanese LNG based prices have historically been much higher than other global market prices. The resulting distortion would, in its view, put an additional burden of Rs. 7000 to Rs. 8000 crore on consumers.

The other argument in defence of a price hike that has been put out by the Petroleum Minister Veerappa Moily is that India's dependence on gas would only rise over time, and if prices are not set at "competitive levels" investment in domestic production would not occur, leading to increased import dependence and a high oil import bill. Given the cost effectiveness and environmental advantages associated with natural gas, the global demand for the fuel has indeed risen sharply in recent decades. In India too, capacities using technologies that can substitute gas for other sources of energy have been created since the 1990s. As a result, gas utilisation has risen faster than domestic production and availability, resulting in imports of Liquefied Natural Gas (LNG) that is regassified in domestic facilities for local use. Imports began in 2003 and have risen sharply to reach 15.2 billion cubic metres (bcm) by 2011. Production, which was at 27.9 bcm in 2000 rose to 52.2 bcm in 2010-11 and was marginally lower at 47.6 bcm in 2011-12.

However, the premise that price alone would ensure more exploration, discovery and production of a difficult-to-find and exploit resource like gas is indeed optimistic. But even if price must be set to encourage investment in domestic gas production, some principle of cost-plus pricing once discovery occurs would be better than merely using the prices prevailing in distorted global markets. As of now, using a version of the Rangarajan formula is only a way of delivering a bonanza to current producers of gas.

To this the Petroleum Minister's argument is that: "Two-thirds of the gas produced in the country are by PSUs and the new pricing will apply equally to them and they stand to benefit more out of it." As noted earlier, given the fact that the consumers of gas are also predominantly in the public sector, the government (and therefore the tax payer) is not much of a gainer, while private sector RIL is. In fact RIL has been gaining in steps from the evolving gas pricing regime. In 2004, RIL had won a bid to supply 12 mcmd of gas to the National Thermal Power Corporation at $2.34 per million British thermal units (mBtu). That was the then prevailing market price. But thereafter the price rose significantly, permitting RIL to propose a higher price in 2007, when it arrived at an agreement with the government to price gas from the KG-DG field at $4.20 per mBtmu. RIL had proposed a value of $4.33 per mBtmu, which was examined by a committee of Secretaries. The committee more or less accepted RIL's proposal, recommending only a marginal lowering of the price to take account of appreciation of the rupee. As a result RIL reneged on its earlier offer to NTPC. Now RIL is poised for one more price and profit hike.

Given the wave of scams and the perceptions generated by the way policy has served the growth of Reliance as a group, this has spurred the new round of allegations noted above. But the issue is more fundamental. The creeping reform of the 1980s and the accelerated liberalisation of the 1990s and after have changed the relationship between state and capital in India. The rise of the Reliance group is itself illustrative of that change. Increasingly, the government has presented itself as being in partnership with private capital, and eager to prove that it would not "renege" on the contractual relationships it forged with private industrialists. In the process it was inevitable that at different times and different circumstances one or the other business group had a special relationship with one or the other segment of the state, gaining substantially from it.

Offering access to the nation's mineral reserves in the name of finding resources to exploit them has been one of way in which that partnership between the state and private capital has evolved. Unfortunately, mineral, oil and gas reserves are limited. So providing access to some implies excluding others. The problem is that actions which in the first instance are justified in terms of expediency are soon influenced by design. And that design involves in the final analysis an engineered redistribution of national income and wealth in favour of a few of India's capitalists.

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