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FROM THE RINGSIDE

Oil's well that doesn't end well

Indian newspapers have extensively reported the Petroleum Minister's statement abroad indicating that the Government is ready for hard decisions — raising prices and not seeking soft options through duty adjustments. Ministers articulate sensible economics when speaking to investors abroad but revert to the path of least resistance on their return home. We hope Mani would be an exception.

Whether the current prices of $ 55 a barrel represents the ultimate peak or prices are likely to cross $ 70 a barrel, as predicted by some pessimists, is irrelevant. At any rate, the prices at which we contract the Arabian Light Crude is close to $ 40 a barrel. The present price peaks represent a long-term dis-equilibrium between supply and demand; prices in the foreseeable future are unlikely to return to the comfort zone of $ 25-30 a barrel. The demand pull factor is relentless. The Chinese soft-landing is notional because recent analysis suggests that their economy continues to grow at around 9.5% and petroleum demand, notwithstanding three successive price hikes, rising between 15-18%. In India, the projected growth rate of 7-8% is being fostered partly through subsidized energy prices which is unsustainable. The electoral outcome next week in the USA is unlikely to alter the security paranoia which has gripped America and supply uncertainties from major oil producing countries in the Middle-East will remain unabated.

We must recognize that energy must be priced at its economic cost and subsidies either by oil companies (anyway they are owned by the Government) or Government themselves be transparently funded. For decades, the Government was in the business of micro-managing petroleum prices but formally got out of it by dismantling the Administered Price Regime (APM) in 1997. Diesel was moved to import parity price with an approved phased programme of dismantling the subsidy on kerosene and LPG, and during the transition the budget directly bearing the subsidy burden. The NDA regrettably brought back the APM instead of leaving these decisions to oil companies. Ram Naik delighted himself in TV appearances informing us of the emerging consensus within NDA on prospective price increases. The UPA Government has perpetuated this distortion. Mani is one of the brightest Ministers of this Government with sound understanding of economics. Television appearances justifying every paise increase in petroleum prices or for postponing decisions masks the truth that these exogenous events are beyond Government control and more so the subsidies, more often than not, do not benefit the intended beneficiaries. Illustratively, kerosene subsidy has generated a new commercial enterprise for profitable adulteration than lighting poor homes. Subsidy targetting for the poor is a key challenge.

The plain fact is that prices today are calibrated around $28-30 a barrel whereas oil companies are contracting supplies at $38-40 a barrel. The difference of $10-12 a barrel must be paid by users or substantially by users with the balance coming out of budget support. Failure to do so is severely impacting the financial health of oil companies. Indian Oil registered a 31% fall in its second-quarter profits. The full year earnings of Indian Oil may drop by 4% while Hindustan Petroleum and Bharat Petroleum may also register a 3% decline. Oil companies are in financial distress.

The option of mitigating the burden on consumer through duty adjustments cannot be pursued perennially and aimlessly. Aimless because duty structures must reflect long-term fiscal policy directions and not ad hoc responses to unexpected price volatility. Perennial because budget-making is an annual exercise and except for exceptional events, major duty changes should be part of the budget-making process. The Lahiri Committee's recommendations expected by end-November should not be pre-empted by major duty adjustments merely to avoid taking the more sensible decision on price increases.

Fiscal policies should be predictable and stable to attract the large investments for the development of Hydrocarbons.

Our approach should reflect four key considerations.

• First, on the demand side. We should lower the demand curve by allowing price elasticities to operate through appropriate pricing of the products. In passing the burden substantially to the consumer, we can always differentiate segments which we wish to protect through continuation of subsidies and these should be borne by the Budget.

• Second, the UPA Government is rightly committed to strengthening the health of PSUs through managerial and financial autonomy. It would be ironic if the Government, while guaranteeing autonomy, continues to micro-manage key price decisions which are central to their working.

• Third, the Energy Efficiency Bill and the Energy Audit functions need not remain ceremonial instruments. An implementation plan should be drawn and implemented with vigour. Energy conservation should be a national priority in the light of the current oil scenario.

• Fourth, on the supply side, fullest encouragement is necessary for the implementation of the NELP. A regulator for both upstream and downstream for the hydrocarbon sector is a matter of priority; the Ministry should not become the micro-managers of commercial exploration decisions. Mani's aggressive oil diplomacy needs our fullest support for enabling both public and private sector to acquire oil equities abroad and explore options on new sources of energy. We also need not be inhibited by our deep-seated reservations on the security of transit routes to harness the large reserves of Iran and other Central Asian Republics.

Finally, we need an Integrated Energy Policy which moves away from excessive dependence on fossil fuel-based energy. Kirit Parikh is working on the contours of this new energy policy. Montek himself, and subsequently I, had overseen the Steering Group on Integrated Energy Policy in the context of the Tenth Plan. We also need to harmonise the sometimes asymmetric interest of various Ministries of Coal, Petroleum, Power, Non-Conventional Energy, Nuclear Power. The economic options of non-conventional energy sources needs fresh consideration in the light of current price trends. Low energy intensive activity, particularly in services, where we have comparative factor advantage deserve particular encouragement. I would urge the creation of a Cabinet Committee on Energy under the Prime Minister which can oversee the implementation of an Integrated Energy Plan.

High energy costs will stay with us and ad hoc responses detract sensible decision making. Mani is too clever not to realise that petroleum pricing cannot be pursued through a Panchayati Raj model of excessive consultations. The world must adjust to an era of high energy cost. So must India.

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