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FROM THE RING SIDE

Petroleum needs hard decisions

Last week, crude prices crossed $52 a barrel, auguring perhaps a new era of high energy prices coupled with volatility. One must sympathise with both P Chidambaram and Mani Shankar Aiyar. Chidambaram because this exogenous factor could upset his dream of an investment-led growth, a booming stock market, a new commitment to reforms and stable macro-fundamentals. Aiyar because it is bringing to an end the jugglery performed over the last four months in duty structures to protect the consumers.

The predictions about oil futures have become even more uncertain than ever before. Barton Brigg, who is considered somewhat of a guru on equity market, attributes 6-7 dollars of oil prices to a 'Terrorism Premium'. Who knows whether this value is right or wrong, but security uncertainties will continue to cloud oil price behaviours even after the US elections. The room for manoeuvre on the supply side, except somewhat in the case of Saudi Arabia, looks more limited, while the demand in large emerging markets, particularly India and China, grows at a scorching pace.

Whatever be the success of China's soft lending, it is unlikely that even on their lower growth trajectory of just around 9-10 per cent, concentrating on infrastructure will lower the demand curve for energy. We ourselves would like to grow at 7-8 per cent, and if past is any guide to the future, oil consumption is likely to grow. The days of cheap energy are over and economies all over must adjust to less energy-intensive activity and begin to price fossil-fuel-based energy more efficiently.

Aiyar has been admired not only for his intellectual and debating prowess but his ability to make 'hard statements' and accept 'hard knocks'. Some of the hard decisions he needs to take:

• Chidambaram needs to be reminded that it was under his stewardship as finance minister in an earlier government, with the consent of Left parties participating in the Cabinet, that a decision was taken to dismantle the Administrative Price Mechanism (popularly known as APM). Based on this, diesel was priced at import-parity levels, mitigating the cross-subsidy regime and adopting a phased programme for tapering out the subsidy on kerosene and LPG, with the Budget directly financing the burden during the transition. There was also a medium-term programme for moving towards a more rational duty structure. It must be said to the discredit of the previous NDA government that the blame for reinventing the APM rests with them. Ram Naik began to tamper with what should have been left to market-based decision by oil companies. Given the composition of the present UPA Government, it is not surprising that this distortion has become compounded with ad hoc tinkering in the duty structure to mitigate the impact on consumers.

Not many know that Aiyar is the first trained economist to serve as our Petroleum Minister, and it would be somewhat ironic if he decides not to learn from his younger brother Swaminathan Aiyar, who although a trained physicist is busy preaching sound economics!

• Beyond this, comprehensive action needs to be taken both on the supply and demand side; to moderate demand without unduly hurting growth and to enhance supplies. These entail measures connected with tariff calibration, subsidy management and improving self-sufficiency.

• On tariffs, customs duty on crude oil at 10 per cent is among the highest in the world; China, Malaysia and Thailand are at zero per cent, with Korea and Philippines at 3 per cent. We need to adhere to an earlier decision of importing crude at 5 per cent and downstream products at 10 per cent. Incidentally, it is somewhat bizarre that while a lot of India uses fuel oil for power generation due to a lack of reliable grid power, fuel oil atracts a peak duty of 20 per cent; or that a downstream product like LPG and SKO attracts 5 per cent while crude is at 10 per cent.

We need to stop tinkering with the duty structure in an ad hoc way and implement a long-term sensible path. Injecting uncertainties in the duty regime will not attract investment in the hydrocarbon sector.

• A charge of Rs 50 per tonne on crude as calamity payment has no rationale—the only calamity now is the high crude price!

• On subsidies, which currently cost Rs 15,000-Rs 18,000 crore, we must go back to basics. Whom does the kerosene subsidy benefit? Not so much the rural poor as the rich who make adulteration their business. Similarly, higher-income groups are the important beneficiaries of LPG subsidy. In line with the UPA's Common Minimum Programme (CMP), subsidies must be directed at the lowest strata of society and to the genuine poor, namely people Below the Poverty Line (BPL).

• On the demand side, by artificially protecting consumers either in the false belief that oil prices are about to crash or come down significantly or to seek temporary relief through measures like Oil Bonds is hardly a sensible response. Consumers have to bear the burden of higher oil prices and, transparently done, will understand that the Government is not responsible for events on which it has little control. Price elasticities must work to moderate demand growth. Growth based on subsidised, low energy prices is not sustainable.

• The Government must move out of the business of pricing. Aiyar must keep his promise of introducing the Downstream Regulatory Authority in Parliament—the provisions of the Bill should genuinely invest the regulator with authority (Ram Naik did not want to do this) and both the selection process and the personnel selected must have credibility and inspire confidence.

• In enhancing self-sufficiency in the petroleum sector, the Government started the National Exploration Licencing Policy (NELP) from 1999. Four rounds of NELP are already over and the fifth round is planned in January 2005, and yet the DG of Hydrocarbons (vacant of six months) functions with the old mindset of the disbanded and infamous DGTD in trying to micro-manage decision! We need, in addition, to a Downstream Regulator, an Upstream Regulator. This is necessary for attracting greater participation in the exploration programme.

• Another aspect that has received inadequate attention is to enhance energy efficiency and foster economic activity which is energy optimising. The Ministry of Power had piloted the Energy Conservation Bill, but we see little implementation in practice. This should receive priority.

• Finally, it must be recognised that the days of abundant, cheap fossil-fuel-based energy may be nearing an end. There are frightening environmental implications as the large populous configurations of India and China become energy guzzlers and contribute so to the already alarming rate of global warming. Research & Development on alternative fuels and non-conventional energy has suddenly become attractive given likely trends in crude prices. The Ministry of Non-Conventional Energy Sources needs to be energised and the recent report on Hydrogen Energy implemented with speed. Nobody doubts Aiyar's empathy for the poor or abiding faith in a development model based on Panchayati Raj. However, right now, Petroleum deserves not knee-jerk reactions but the skills of the trained economist at the helm of our affairs in the Petroleum Ministry to meet many complex challenges arising from these new price peaks.

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