

We need to manage supply better

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Oil prices have softened with analysts projecting further downward adjustment. If this is true, a significant risk for sustained global growth is mitigated. Nonetheless, the long-term inequilibrium between demand and supply of fossil fuel, coupled with environmental risks, will continue to exert upward pressure on oil prices. Contributing to this in no small measure will be the increase in demand from emerging markets like India and China.

Hopefully, the fall in oil prices will not lull us into complacency and make us neglect key energy concerns. Quite a few of these are mentioned in the Kirit Parikh report on Integrated Energy Policy. Last week I focused on managing demand and energy efficiency; this week I will focus on supply management and regulatory oversight.

The supply side recommendations in the report are a mixed basket: it is indeed a difficult and complex task to deregulate and regulate primary energy sources, given the long history of public dominance and a variety of interest involved, but it is also essential to get it right.

Notwithstanding current hype on alternative energy forms, the report is candid enough to admit that "even if India succeeds in exploiting its full hydro potential of 150,000 MW, the contribution of hydro energy to the energy mix will only be around 1.9-2.2 per cent. It is clarified that the hydro share in the primary energy mix comes out lower because of the way oil equivalence of hydro electricity is calculated.

Similarly "if a 20-fold increase takes place in India's nuclear power capacity by 2031-32, the contribution of nuclear energy to India's energy mix, is at best, expected to be 4-6.4 per cent."

In short management of coal remains critical in the short and even in the medium term. From this point of view one is tempted to ask why so little deregulation in the coal sector?

The proposal is to allow coal blocks that CIL can't bring into production by 2016-7 to go to "other eligible candidates" for development by 2011-12. But given the general tendency to set targets higher than achievements, at what point will CIL admit that it will not bring these blocks online by 2016? Will this be early enough for the "other eligible candidates" to bring them online?

How realistic are the proposals to allow private entry? Coal exploration is still being done only by the Central Mine Planning and Design Institute, which has meant that estimates have been slower to come and somewhat unreliable.

The Coal Mines Denationalization Bill, 2000 has been pending in Parliament for six years. In the meantime, the government has merely been allowing private companies to exploit the coal for power generation, captive purpose.

Besides it is hardly encouraging that language about private participation seems to have been diluted from the draft NIEP, which proposed had that "finally, isolated deposits of all hydro carbons including coal may be tapped economically through sub leases to the private sector." (Draft NIEP)

Railways, and their role in transporting coal from pit head to power plant, are not mentioned in the coal section. Why not? Nor is the option of improving power transmission lines to bring power from pit head plants elsewhere, if the coal itself cannot be moved been considered.

Similarly on gas, it's simply put: the best way to encourage exploration to expand the local supply is to allow private companies to charge market prices for the gas they discover. The current approach on regulated prices with a "fair" return until some of the potential reserves become available is unlikely to make the potential reserves become available.

Volatility remains an important issue. Some degree of shelter from volatility is important. However, simply setting prices as the average of several months is not necessarily the best way to do it. This essentially makes the government bear the risk as it smoothes the price. Why not allow users of primary energy to engage in forward contracts to hedge their prices? Or to expand the types of contracts they offer to their consumers, who may have varying degrees of tolerance for risk? This creates a private market for risk and risk reduction.

On fuel pricing, the idea that "in a competitive set up, the marginal use value of different fuels, which are substitutes, should be equal at a given place and time so that the price of different fuels at different places do not differ by more than the cost of transporting the fuels," may not be the best guide for policy. This is a long-run statement about the choice of fuels. Fuels may be substitutes over the long run, but in the short run (which could be on a scale of years), specific choices about conversion of fuel to electricity, or transport, or other uses have been made so that fuels are not direct substitutes. The marginal use values are unlikely to be the same at any point in time.

What is more important is to provide some means of clarity and transparency that enables the market to reasonably project long run shifts in fuel prices, and make decisions about investments based on these. The more political and regulatory uncertainty there is, the more these resource allocation decisions will remain skewed.

There are three other issues, which at the very least, deserve a brief comment.

- The Committee has suggested a creation of a National Energy Fund (NEF) to finance R&D on the alternative forms of energy excluding atomic energy, which is being separately funded. This is proposed by a special levy. I am somewhat hesitant to accept that we add one more cess to an otherwise long list.
- The report has proposed a subsidy by entitling directed households of 30 units a month by kerosene and LPG purchases from local community up to 6 kg of LPG through a system of debit card. In principle rationalising subsidies through better targeting the intended beneficiaries is sensible. The implementation mechanism needs to be carefully worked out in consultation with State Governments.
- Finally, it is a pity that the Terms of Reference of the committee left out the issue of regulatory oversight. Conflicting regulatory regimes and the absence of a super-regulator for energy will be a serious handicap in implementing an Integrated Energy Policy.

On the whole the new focus on Energy particularly on the need for an integrated approach is welcome. But what is the path forward and the assurance that a softer oil regime and other distractions will not push this to a back burner? Energy security does remain critical in our quest for sustained development.