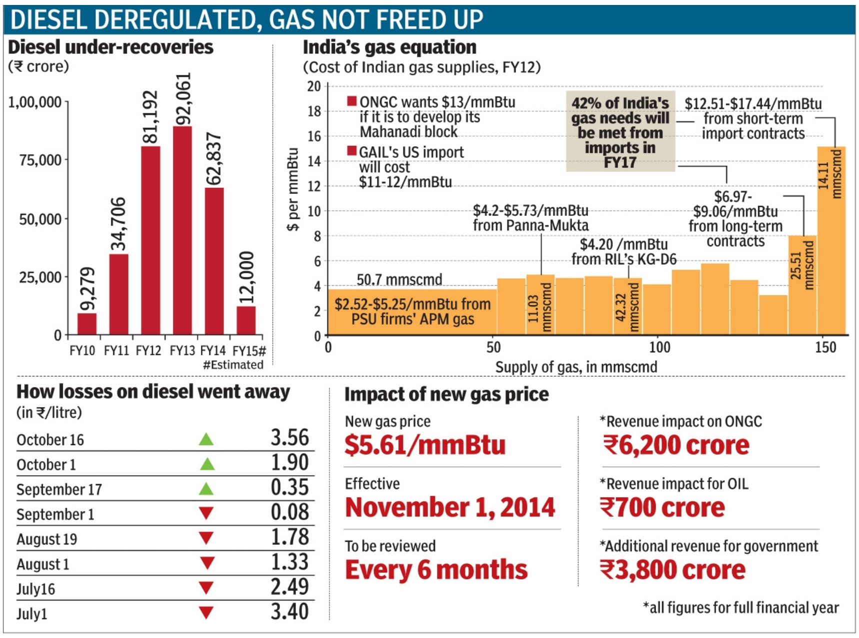
Government gets its strategy right on diesel and so spectacularly wrong on pricing of natural gas

If gas fields are not viable at $5.61, this will be cleared on a case-by-case basis. In the case of defence, more than 49% FDI is to be cleared the same way. Ditto for cases where taxman decides to use the retro tax which is still on the statute ... that’s a lot of discretion with government

Few can doubt, the government has got it completely right on freeing up diesel prices. Market prices are the right way to go, but if these lead to hiking of consumer prices, that’s going to invite political protest. So, thanks to the UPA’s 45-paise monthly hike policy, freeing up diesel prices has meant prices have actually fallen R3.37 per litre. As a result, people will not look at deregulation with suspicion, more so since the way oil prices are going down, diesel prices may see a few more cuts before they go up … so, by the time they start rising to levels beyond what they were a few days ago, consumers will have got used to it in quite the same manner they have got used to petrol prices being market-linked.



Which is why it is so frustrating to see how the government got it so wrong on prices of natural gas. After all, as prime minister Narendra Modi understands when he speaks of the need for natural gas grids, even if you import gas at $11-12 per mmBtu, the price of piped cooking gas is still 50-60% cheaper than that of non-subsidised LPG. That is, at least in cities, the government could have built up natural gas pipelines and offered citizens gas at just slightly higher than what they pay for LPG today and had no subsidy burden. And if it had increased prices of local gas prices to the $8-9 recommended by the Rangarajan committee, once local supplies had commenced, the price citizens paid for piped cooking gas would have been the same as that paid for highly subsidised LPG—anyone who has piped cooking gas from Indraprastha Gas in New Delhi and Mahanagar Gas in Mumbai can vouch for this.

Over the next few weeks, readers will hear lots of triumphant talk of how the government saved citizens from the UPA's marauding policies by ensuring the "upward revision in gas prices will be approximately 75% less as compared to the price arrived at using Rangarajan formula" and that "approximately 80% of the additional revenue due to revision in gas price will go to the Government companies". That this was done by removing the Japanese LNG import component from Rangarajan—bright TV anchors will talk about how this was right considering Japan does not produce natural gas. Others will talk of how the Russian gas price is to be taken in place of the "National Balancing Point price for the Russian consumption considered under Former Soviet Union (FSU) countries".

Much of this is mumbo jumbo. As this column proved with data, excluding the Japanese price lowered the $8.3 per mmBtu price under Rangarajan by just $0.3 ("The gas about gas", goo.gl/C0mpu8), nowhere near the 75% reduction-in-the-increase number being talked of today. That was done by simply putting in random numbers to arrive at a pre-determined number in much the same way a maths problem can be solved—by dividing, subtracting, multiplying and dividing—as long as you know the answer. What is the point of looking at prices in consuming areas—and that is all the NDA's formula has done—if this is not going to take into account, as the government press release itself states, "the transportation and treatment charges"?

There are two things readers need to watch over the next few months, and yes, let's forget about Reliance Industries for a while, unless of course your name is either Prashant Bhushan or Arvind Kejriwal who spooked even Narendra Mod so much so that he couldn't do the right thing on natural gas pricing.

Watch out for whether the state-owned ONGC decides to commence production at any of its deep-water/ultra-deepwater fields like the Mahanadi one where ONGC wanted a price of $12-13 to be viable. Chances are it will not. Two, since the state-owned GAIL is just in the process of signing up for its third shipment from the US where prices of natural gas are around $3 per mmBtu, will GAIL supply this to consumers “less the transportation and treatment charges”. It won’t, and that’s why the pricing exercise isn’t worth the paper it is printed upon. GAIL’s gas will not be available to Indian customers at under $10-11 per mmBtu.

But, various spokespersons will tell you, there is a provision to hike natural gas prices for ONGC and RIL-types who have discoveries in deep water areas. “For all discoveries after this decision, in Ultra Deep Water Areas, Deep Water Areas and High Pressure-High Temperature areas, a premium would be given on the gas price to be determined as per the prescribed procedure”, the press release states.

What is this ‘prescribed procedure’? It’s not clear but petroleum minister Dharmendra Pradhan told FE that, in the case of gas fields that are not remunerative at the $5.61 price, the matter will be escalated to finance minister Arun Jaitley’s level.

Given Jaitley’s well-known pragmatism and attention to detail, the implicit assumption is that the ONGCs and RILs will get their higher prices and all will be well with the world. The evil UPA’s gas hike will be kept to the minimum to ensure consumers aren’t hurt, but companies will not be impacted since Jaitley will keep in mind their higher costs. Given that there’s only so many ways you can break an egg, that’s obviously so much hypocrisy. For one, consumers are equally badly hit when there is no gas and gas-based power plants don’t run—indeed, under the PPAs signed, even if these gas-based power plants don’t run, consumers have to pay for their capital costs—this runs into several thousand crore rupees each year. Two, whether you pay higher prices for local gas or for imported gas, the net impact is the same; indeed it is higher for imported gas.

What is more worrying, from an investor point of view, is the levels of government discretion once again getting built into the system. The refusal to free up gas pricing—surely a 3-4 year roadmap could have been drawn up like the UPA did for diesel?—has meant all discretion lies with the petroleum and finance ministries. The refusal to remove Pranab Mukherjee’s retrospective tax means a committee is to have the discretion over whether the taxman is going to abuse this power—by the way, in both the Vodafone and Shell capital infusion cases, the taxman used a retrospective tax amendment. In the case of defence FDI where the government buckled under pressure of domestic biggies and kept FDI to under 51%, the FIPB will have the discretion to allow higher FDI. Apart from worrying investors who are looking for more transparent rules, all that discretion is going to be fodder for several future CAG reports which will look at the undue benefit to ONGC/RIL by allowing gas pricing at $8.7 against the formula price of $5.6 … were the costs of the deep sea blocks overstated? You get the drift.