

GAS PRICING POLICY

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BACKGROUND:

There is a heated debate going on, since last few years, as to what is the right price for gas in India and what should be the gas pricing policy of Govt. of India. The arguments made till now have been emanating from individual stakeholders with limited objectives of ensuring their gains and comforts with respect to their own risk perception. Nobody has tried to take a holistic view of what should be the broad objectives of such a pricing policy and what needs to be done to achieve these overall objectives.

I was closely associated with the drafting of the first production sharing contract in India which gave marketing rights, at market determined prices, for gas to be produced from the licensed area. This step, taken in early 1990s, marked the transition of gas markets in India from administered pricing regime to market determined pricing regime. Since then, gas markets in India have developed rapidly and imports of gas have become a reality to increase the supplies as per market demands. I have had the privilege of being actively associated in this entire transition process and it has given me fairly good insight and understanding of the gas markets and its dynamics in India.

Based on this understanding and knowledge of the gas markets, I have tried to analyse the issue of 'Gas Pricing' and present an objective analysis of what should be done and what should not be done.

OBJECTIVES OF POLICY:

The policies in gas sector(including its pricing) should aim at achieving ***rapid and sustainable development of Indian economy.***

In order to achieve this broad objective, following needs to be achieved through the policy instrument:

1. **Environmental compatibility:** The policy should result in an energy-mix which will have atleast 25% contribution from gas (Currently

share of gas in India's energy-mix is less than 10%, which is far too low compared to world average of almost 25%). This is necessary in view of the emerging global awareness and concern about 'Climate change' and 'Global warming'. Recent announcements of Government after Copenhagen meet to reduce emission intensity of India's GDP is not possible to be achieved unless share of gas in energy mix is increased substantially.

2. **Reduced energy intensity of economy:** The policy should aim at reducing the consumption of energy per unit of GDP. This calls for more efficient use of energy in economic activities. Gas because of its properties is best suited for achieving highest possible efficiency of use amongst current sources of commercial energy. Thus, policy should ensure increased share of gas in energy mix.
3. **Ensure adequate availability:** If share of gas in India's energy-mix is to be increased to achieve above mentioned two objectives, then it is necessary to ensure that adequate supplies are made available to potential users who would like to buy gas. Though substantial new reserves of gas have been found in recent past in India, the demand potential for gas is far in excess of potential supplies and there would be considerable imports required (as is the case with all other potential energy sources). Thus, policy should facilitate imports of gas as LNG as well as by cross country pipelines. This calls for pricing regime to be in sink with international trends in gas markets.
4. **Ensure level playing field, transparency and fair competition:** It is necessary to ensure fair competition by providing a transparent pricing mechanism and avoiding artificially lower or higher prices for certain categories of users or suppliers. Differential pricing, through arbitrary controls, for users and producers would not be fair to all players in the economy and would promote inefficiencies and drastically impact the potential for growth.
5. **Promote investments in creation of energy infrastructure:** The policy should ensure that investors are comfortable with stability of policy regime and they do not have 'political risk' perception with respect to a policy on pricing which has direct implications on their revenue stream. It is necessary to ensure this so as to facilitate huge investments which are necessary for augmenting gas based power generation capacity, increase gas exploration activities, imports of gas and development of gas pipelines. Creation of adequate energy infrastructure is absolutely essential to achieve rapid growth rates.

ANALYSIS OF PRICING POLICY OPTIONS:

The options possible for gas pricing are analysed for their merits/demerits and/or suitability, in Indian context, in following paragraphs:

- **Controlled or administered pricing regime:**

Such regimes can work effectively only in case of either of the following scenarios:

1. If the indigenous gas resources are capable of producing gas at rates which are far in excess of potential demand in the local markets
2. Government has at its disposal adequate resources to provide budgetary support to industry to compensate it (for the impacts arising out of such administered pricing regime) to ensure level playing field and fair competition so as to ensure sustainability of growth and promote investments in energy infrastructure.

If we analyse the condition of Indian economy, then neither of the two scenarios are possible in foreseeable future.

In view of this, such pricing regime, if followed, can only restrict the growth of gas industry and stagnate the economy.

- **Market determined pricing or free pricing:**

Government of India had very categorically announced its intent to gradually move towards market determined pricing in gas sector. On the basis of such policy initiatives, many investors have invested in activities like gas exploration, gas imports and gas pipelines. Looking to the future needs to sustain growth, lot more investment is required to be made and this can be achieved only if the policy regime remains consistent, transparent and market friendly.

Globally the experience of most of the economists has very clearly established that there is no better alternative than market determined pricing as this mechanism is able to respond to a complex set of variables far more efficiently than any human intervention (i.e. administered pricing) can possibly achieve. Further, this mechanism avoids arbitrariness, which is unavoidable in case of human

intervention, in response to demand/supply side forces and to that extent it is a very fair and transparent mechanism.

Further, if adequate supplies are to be ensured in the market then considerable quantities will have to be imported. Unless the pricing mechanism is able to respond to international trends in gas prices, it is impossible to ensure adequate longterm supplies from international markets to Indian economy.

- **Hybrid of free and controlled pricing:**

In my opinion, this truly is not an option as it fundamentally lacks clarity and cannot be considered to be a philosophy. Any regime which tries to talk about such an approach gives clear signals that they lack clarity of purpose and they are confused about what to do.

Unfortunately, bureaucrats and politicians would like to suggest such an option.

Such hybrid of philosophies would essentially mean a highly confused regime wherein some key decision makers have all the discretionary powers to decide gas price in a given market. They will then come up with absurd or irrelevant logic to justify their decision and such regime cannot fulfill the broad objectives outlined above for the economy of India. Such policies would be highly subjective, unstable and would ultimately affect the sustainability of the growth process.

Unfortunately at this crucial juncture, when Indian economy is on growth path and gas markets are evolving, Government of India seems to be thinking of adopting a hybrid approach despite their stated policy of liberalizing the gas markets to market determined pricing regime.

SUGGESTED POLICY MEASURES FOR GAS SECTOR:

Based on above analysis, following policy measures are proposed so as to achieve broad objectives outlined in the beginning.

- Allow free, market determined pricing based on free interaction between buyers and sellers of gas

- Buyers and sellers should be free to choose their counterparts, based on their own comfort, and allowed to negotiate an agreement for short/medium/long term supply of gas at mutually agreed terms
- Unrestricted movement of gas should be allowed within the country
- Unrestricted imports of gas should be allowed
- Ensure development of wide spread gas transmission network to ensure that no location in India would be more than 100-150 kms. away from high pressure gas pipeline network. This is a very basic and essential infrastructure for gas sector development and ideally it should be developed in next five years.
- Government should not intervene at any stage, either on its own or at the instance of buyer/ seller, to bring in selective price controls, to exercise control on gas allocation and/or force amendments in terms of agreements to enforce such selective controls
- Agreements between buyers and sellers will be allowed to continue to operate and disputes, if any, between contracting parties should be settled by due process of Law only
- Levies on gas sales should be uniform across all states
- Encourage and ensure that an ‘on-line trade’ is developed for gas on any of the existing commodity exchanges for settlement through physical delivery. *This will ensure a true and transparent market determined gas price discovery mechanism.* With developments in gas pipeline networks it is possible to ensure physical delivery of gas traded on such exchange by enforcing ‘open access’ on gas pipeline systems. This single initiative will go a long way in ensuring smooth transition to market determined pricing and will help in bringing required liquidity in the market and evolve a very matured gas market in India.