CHAPTER XIII

SUMMARY AND RECOMMENDATIONS

The study was carried out with the following objectives:

1. To trace the historical evolution of the pricing policy of crude petroleum and petroleum products adopted by the Government of India after independence,

2. To critically evaluate the various aspects of the policy from an administrative and economic point of view,

3. To examine the alternatives available to the Government at different stages of this evolution.

4. To examine the impact of pricing policy on the consumption of oil products, its effect on demand - supply imbalance.

5. To briefly examine salient features of the Government policies relating to exploration and development, refining, marketing and distribution, imports, oil conservation and natural gas.

In Chapter III, the salient features of the Government policies relating to exploration and development, refining, marketing and distribution, imports, oil...
conservation and natural gas were examined in relation to the effects of these policies on demand and supply of oil products. In Chapter IV, the trends in growth of oil products consumption and the demand projections were examined in order to emphasize the point that demand for oil, unless regulated through economic policies, can belie the expectations of the most efficient planner and can have disastrous consequences on the economy. Pricing is one of the most effective tools the economic policy planner can use for regulating demand growth.

As India have to depend on imports for meeting the growing demand for petroleum products, there is always the possibility of a demand-supply gap. The refineries were set up with a view to reduce dependence on the import of products, but the predominantly middle distillate oriented demand structure was not conforming to the normal refinery configuration. In spite of modifying the design in such a way as to produce more of middle distillates, the imbalance remains. The pricing structure which encourages excessive use of kerosene and diesel as compared to petrol is primarily responsible for this imbalance. Chapter V highlights this aspect of pricing policy.

Chapters VI described the petroleum pricing policy at the time of independence and subsequent developments in the earlier days. Chapter VII examined in detail the recommendations of the first four oil price committees and consequent changes in the pricing policy. The principles followed by Government of India at present for pricing refinery products were first enunciated by the Oil Price Committee.
1976. This chapter analyses the recommendations of this Committee which include the use of Average Cost Price as an acceptable alternative to Long Run Marginal Cost and the use of retention pricing in refineries. The present pricing mechanism is based on the procedure suggested by the Oil Cost Review Committee, 1984. Chapter VIII described this procedure step by step and throws light on the various oil pool accounts.

Chapters IX outlined the theoretical aspects of pricing of crude oil and natural gas. Chapter X examined the three objectives of pricing policy, viz. economic efficiency, financial viability and social equity. Since the present pricing mechanism fails to fulfil the efficiency criterion, alternative approaches are required, but not at the expense of the other two criteria. A few suggested alternatives were recounted in Chapter XI.

It has now been widely accepted that the Administered Pricing Mechanism cannot sustain the oil industry against international market forces and sooner or later it will have to give way to free market pricing. Chapter XII outlined the options before the Government and enumerated the recommendations of the Sundararajan Committee and the R-Group constituted by the Government with a view to open up the oil economy and restructure the industry.

The study leads to the following conclusions:
In the earlier years, the Government have not been adequately familiar with the intricacies of the international oil industry and took a long time in acquiring the knowledge essential for meeting the manipulative strategies of the international companies.

In the initial years of independence, very little emphasis was placed on exploration and development, in spite of the fact that the industrial policy placed oil in the State sector.

The formation of ONGC itself was unduly delayed, and when it was formed, it was not equipped with adequate financial and administrative authority.

In spite of this handicap, ONGC could discover oil in the Cambay region and in Bombay High much earlier than expected and contrary to the belief sought to be propagated by the international companies.

The Government was reasonably successful in maintaining the level of imports at affordable levels by regularly enhancing refinery capacity and by controlling consumption growth.

India could establish coastal refineries with the help of international majors within a few years of independence, but conditionalities usually unacceptable even to lesser countries enabled the companies to exploit the ignorance of the
Government. This prevented the Government from exercising control over the sourcing of crude and the pricing of products.

- In spite of enhancing refinery capacity considerably, there has always been a gap between demand and supply. This gap is practically a problem of middle distillates.

- In spite of the continued dependence on foreign supplies, the country's vast size and economic backwardness. India has been able to ensure adequate supplies of oil products at stable, affordable prices over the entire country through an efficient, State owned marketing network.

- There is considerable scope for conservation of oil products and for reducing the share of oil in the commercial energy consumption by encouraging the use of coal, electricity and non-conventional sources of energy.

- The successive oil shocks have affected India perhaps much more than any other country because of the tardiness in exploiting our own natural resources and the consequent heavy dependence on oil imports. As a corollary, these oil shocks highlighted the importance of speedier exploration and development as well as energy conservation.
The Government have not been able to use the pricing mechanism as a tool for ensuring efficient use of this scarce natural resource. This failure has led to considerable misuse of products, particularly kerosene and diesel.

The first two Oil Price Committees under the Chairmanship of Damle and Talukdar respectively did detect the existence of discounts in the international market, but failed to understand the exact mechanism of pricing followed by the international oil companies and therefore could not significantly alter the pricing mechanism.

Although the Shah Committee exposed the malpractices followed by the oil companies, it was the Krishnaswamy Committee (OPC) which introduced a radically new pricing mechanism, which was later modified by the Oil Cost Review Committee.

Even the OPC could not establish economic prices for the products, but emphasised more on financial viability and therefore evolved the retention price concept guaranteeing reasonable returns to the refining and marketing companies.

The OPC could evolve such a system only because of the fact that the Government had, by that time, come to own almost the entire oil industry. Obviously, in a situation where significant share of ownership is not with the
Government, the retention price mechanism will not be appropriate. Extending the present pricing mechanism to privately owned refineries may encourage them to 'gold plate' their installations to avail higher retention prices.

- The present pricing mechanism based on the retention concept is biased in favour of inefficient refineries and does not provide sufficient incentive for cost reduction and modernisation. It also created formidable barriers to the entry of new investors in both refining and marketing.

- There is need to change our economic policies as far as pricing of scarce resources like oil are concerned. The pricing mechanism should be based on sound economic principles. However, socio-political considerations cannot be wished away. Any pricing reform, therefore, has to take place in phases and without causing undue hardship to the economically weaker sections of society.

The major recommendations that emerge out of this study are:

- The monopoly of Public Sector enterprises in exploration and development, refining and marketing should be curbed to some extent in order to introduce healthy competition and to attract foreign investment backed by advanced technology. Deliberate policy measures will have to be taken to reduce the height of entry barriers. Fiscal incentives may have to be provided at least to the first-movers to make new investment attractive. Such investment is
necessary as the surpluses in the public sector as well as the domestic capital market may not be able to raise the finances required for the intensification of exploration activities and expansion of the downstream sector.

- Crude prices should be brought at par with international prices and the public sector exploration companies should devote their surpluses for further development of the oil fields and for evolving exploration techniques suited for Indian offshore and onshore. The present practice of charging fixed rates of royalty and cess should be replaced by *ad valorem* duties to provide incentives to producers for cost reduction.

- Natural gas should be priced at par with the price of the equivalent crude oil in terms of calorific value, taking into account transportation costs.

- All the refining companies including privately owned ones may be allowed to import crude oil and natural gas directly at negotiated prices in order to take advantage of price fluctuations in the international market. They should also be free to export their products in excess of any contractual obligations.

- The domestic refining capacity should be considerably augmented to reduce dependence on product imports and to act as a cushion in case of unforeseen oil shocks.
- The distribution and marketing infrastructure should be strengthened, with more emphasis on pipelines and on improving port facilities.

- Steps should be taken to ensure maximum utilization of natural gas. This is the best method for reducing the present demand-supply gap. Compressed natural gas can be used extensively in city mass transport systems and for supplying piped gas for domestic use. The indigenous supply should be augmented by the import of natural gas from surplus producers through under-sea pipelines.

- In the present economic scenario, there is a strong case for free market pricing. The Administered Pricing Mechanism (APM) needs to be replaced by a Market Determined Pricing Mechanism (MDPM) with selective Government intervention.

- The present retention pricing which is biased in favour of inefficient refineries should be replaced by pricing products ex-refinery at levels determined by international prices.

- Any rational approach towards pricing policy should eschew subsidies as they have a tendency to distort price signals. Such distortions lead to uneconomic consumption and are anti-conservationist. Price subsidies for kerosene, HSD and LPG, if inevitable, should be substituted by direct subsidies and subsidies on equipment.
It may not be possible to introduce all these measures in the immediate future; particularly the deregulation of products such as kerosene and diesel may pose formidable problems. Therefore, it is desirable that deregulation is effected in phases, starting with the pricing of products which are not of mass consumption, such as fuel oil, LSHS and naphtha, and marketing of these products. A beginning has been made by allowing imports of LPG and certain other products and their distribution, but an efficient deregulated market will require better port facilities and distribution network.

Even if exploration, refining and marketing are deregulated, the major share in each of these operations will continue to be with the oil PSEs, which will enable the Government to retain strategic control on the entire petroleum industry. This strength should be utilized to direct the course of deregulation.

Even after the marketing companies are freed from the clutches of APM, they should be subject to the strategic control by a regulatory body to ensure availability of oil products in the remote areas of the country.

A price monitoring system should be set up at the Ministry level with industry participation to prevent monopolistic practices and to ensure supply in every region.
• Lack of transparency and credibility has been one of the major hurdles to the entry of private companies, both domestic and foreign. If investment in India is to become attractive, in addition to the incentives, the State should declare a long-term commitment towards an acceptable economic structure. We should be able to dispel the apprehensions regarding the stability of the reforms.

• The Government should adopt a long-term petroleum policy encompassing all aspects of the industry and openly announce it after a public debate.