India

Energy Subsidy Briefing

JULY 2013

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Cabinet Approves Doubling of Natural Gas Prices

The government of India is revising the system it uses to price domestically produced natural gas, with a steep increase expected next year. On June 27th the Cabinet Committee on Economic Affairs said gas prices should rise to US$ 8.4 per million British thermal unit starting in April 2014, up from the current price of US$ 4.2 per million BTU (Times of India, 2013).

The government has been under pressure to revise prices to spur investment in domestic natural gas production. Also the current pricing policy expires in March 2014.

The new formula for setting prices is applicable for five years and will be revised quarterly.

Historically, prices have been adjusted on an ad-hoc basis. And while companies and the ministries of oil and finance have urged a transition to a formula-based pricing system, they have clashed over the best formula to apply. Given the disagreement, a government appointed committee, the Rangarajan Committee, was tasked with recommending an appropriate formula. The Cabinet Committee on Economic Affairs has reportedly adopted committee's recommended formula, albeit with some changes.

The price hike has been praised by gas companies—as the increase is higher than anticipated—but they have also stressed that they want a plan for moving to liberalized prices.

Critics have accused the Cabinet of pushing the gas price unnecessarily high, to the benefit of private gas companies. The Minister of Petroleum and Natural Gas, Veerappa Moily, has countered that the price hike is needed to improve efficiency and reduce dependency on imports (Indian Express, 2013).

The price increase is a particular point of concern for the power and fertilizer industries, the biggest consumers of natural gas (Indian Express, 2013a). Notably, the government has suggested that it may continue to subsidize the purchase of gas for these companies when the price increases in April 2014 (Mehdudia, The Hindu, 2013).

Rupee's Devaluation May Increase Costs for Oil Producers

The Indian rupee fell 7 per cent against the US dollar between June 1st and June 26th (the rate was INR 60.73 to the US dollar on June 26th) (Shaaw & Rodrigues, 2013). The rupee has been one of the worst performing currencies in June, falling to record lows.

Oil marketing companies, which rely on imported crude oil to supply the Indian market, increased retail prices of petrol to compensate for the weaker rupee. Prices for petrol were raised by Rs 0.75/litre and for diesel by Rs 0.50/litre on June 1st (Nambiar, 2013), and again by Rs 2/litre for petrol on June 16th (Indian Oil Corporation, 2013).

Meanwhile, domestic upstream oil companies have voiced concern that the weaker rupee is increasing their share of the subsidy burden as the cost of imported oil rises. Three upstream companies (GAIL, OIL, and ONGC) currently contribute 37 per cent of the subsidy bill due to the losses they absorb by selling fuel at less than the cost price. With the devaluation of the rupee, this share could rise up to 45 per cent for the current financial year (Money Control, 2013b).

Revision in Power Tariffs: Households and Industry to face Higher Cost

The Cabinet Committee on Economic Affairs has allowed power companies to pass on the costs of importing coal to consumers. Several power projects have complained of inadequate domestic supply and high international prices. This recent decision and falling international prices has brought relief to several power projects and distribution agencies.

Speculators say that the increase in power tariffs could be 17p to 20p per unit, and will be borne by non-subsidized users (i.e., households and industrial units) (Kamat, 2013). The revision in power tariffs is making off-grid electricity, such as solar, more competitive, which has led to several industrial consumers to produce their own electricity. For example, companies like DELL, IBM and Maruti have installed their own solar plants because it is cheaper than buying power from the electricity grid (Shah, 2013).

LPG Subsidy Linked to DBT Scheme in 18 Districts

On June 1st, 18 districts of India began linking subsidies for LPG to the Direct Benefit Transfers (DBT) scheme. In these districts, beneficiaries whose bank accounts are linked to Aadhaar numbers (a unique identification program) receive an advance of Rs.435/- per cylinder on booking a LPG cylinder; the cylinders must then be purchased at the market price (Government of India, 2013).

The 18 pilot districts for DBT have been selected because a relatively large proportion of LPG consumers have Aadhaar numbers. Those without Aadhaar numbers—or bank accounts linked to the Aadhaar numbers—have been given a grace period of 3 months during which they can still buy LPG cylinders at the subsidized price (The Hindu, 2013; Press Information Bureau, 2013). The DBT for LPG scheme is expected to be rolled out country-wide in October 2013.

The new DBT scheme for LPG essentially changes way the subsidy is delivered, but it does not seek to restrict eligibility—all consumers of LPG may request the subsidy. It therefore does not address concerns that the LPG subsidy should be targeted towards poorer consumers.[1] However, in line with earlier reforms, households will be limited to 9 cylinders of subsidized LPG per year.

The quota of 9 cylinders per household appears to have had some effect on reducing diversion to commercial users. Consumption of domestic LPG fell from 2.5 million tons to 2.4 million tons between April and May, while there was a rise in consumption of commercial cylinders (Chandramouli, 2013).

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[1] Indeed, linking the LPG subsidy to the DBT may make the subsidy more socially regressive, given that recipients must have access to the formal banking sector and access savings in order to deal with disruptions in cash flow.

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