ADITYA PURI

Stop scraping the barrel

Ensure proper pricing of oil — subsidies must go

INDIA, for some odd reason, has not been preoccupied with the possibility of sustained high oil prices. This is despite the fact that we are a major importer of oil and are in the middle of a major transition towards much greater energy consumption. It is also despite the fact that we pay through our nose to keep oil prices in check. The oil subsidy bill is likely to be close to Rs 85,000 crore this fiscal year (the budgeted amount was incidentally a relatively meagre Rs 24,000 crore).

Oil prices are the biggest threat to our future. Globally, once growth is restored, most analysts expect demand for oil to grow faster than supply, leading to price volatility and rise. Most advanced countries have, therefore, moved to policies restricting oil consumption in areas such as power, chemical, product transportation, home heating, etc..

However, changes in Asia and elsewhere in terms of abolition of subsidies has been slow. Economics and politics are mixed here and government/consumers have been reluctant to take the tough policy stands required.

We need to examine the possibility that within the next 10 years the world could experience a period of intense volatility with oil prices going through the roof.

The world is not running out of oil. We have around a trillion plus barrels of oil underground and the possibility of several trillion barrels of oil or gas that can be extracted from new sources. Oil demand going forward is expected to increase by around 1.5 per cent per annum. This presumes there are continuous improvements in energy efficiency and use. Supply of oil in the past decade has grown by around 1 per cent per annum. This despite a scenario of high oil prices during the decade which saw major investment by private/national oil companies. Going forward, logistics, supply systems and geopolitics involved in creating additional capacity are expensive and time-consuming and therefore the cost of increasing capacity will be higher.

While oil subsidies might appear to cushion us from high prices in the short term, continuing with subsidies will hurt us badly in the long term. We cannot just transfer the burden to the future.

Most analysts project (presuming modest growth) a convergence of demand and supply by 2020 at around 100 million barrels per day. However, the world never moves in an orderly manner so it is very possible that we have periods of mismatch caused by faster demand growth or slower supply growth or supply can be disrupted by conflicts. Also, the world needs a capacity buffer of at least 4 million barrels a day to avoid market expectations of shortage, pushing up price. So the possibility of oil prices ranging between $125 and $200 during periods of stress (which may not be short) is a distinct possibility.

Where does this leave an oil-dependent, non-significant oil-producing country like India which prices oil below market and funds through fiscal deficit?

While oil subsidies might appear to cushion us from high prices in the short term, continuing with subsidies will hurt us badly in the long term. Let's pay the price in orderly instalments rather than in an explosion of pain at a later date. We cannot just transfer the burden to the future and need to take pro-active steps immediately. These should include four things.

One is removing subsidy. This cannot and must not be a political issue. Subsidies are not targeted and are therefore not reaching intended beneficiaries and the problem is compounded by corruption in distribution. Cheap fuel is also not inducing the required consumer behaviour changes required for conservation. There is no free lunch. Subsidies are not a gift. We as citizens pay for them one way or the other.

Two, we need clear policy for new discoveries on energy efficiency/conservation which balances environment and growth objectives. We need to substantially improve the level of our discovery. We have had some success in this area, but it is obviously not enough. Oil majors spend $40 billion or so every 12 to 24 months. In most countries investments are made by the oil majors but the control of the resources is with the countries. We as a country get very little of this investment. Obviously, something needs to be done to make this a win-win for all parties so that we have more oil.

Three, there should be improvement in current extraction efficiency. We need to ensure that our existing resources are being used optimally. Currently, as per research reports, our efficiency of recovery is way below international standards. We need to ensure that either our own companies achieve this or take foreign help. But the end result must be achieved and time is of the essence because oil price will not remain low for ever. Also, we can destroy our resources in the long run.

Four, we need clear hedging policy. This may need to be a parliamentary committee decision as we will be wrong periodically, leading to witch hunts (which prevent any decision by individuals or government).

In conclusion, it is imperative that politicians of all hues recognise that our fiscal deficit needs to be reduced through ensuring proper pricing of oil so that the money saved can help those that really need it, and God knows we have enough of them.

The writer is MD, HDFC Bank
express@expressindia.com