9

STANDING COMMITTEE ON FINANCE
(2014-15)

SIXTEENTH LOK SABHA

MINISTRY OF FINANCE
(DEPARTMENT OF REVENUE)

[Action taken by the Government on the recommendations contained in Seventy-fourth Report (Fifteenth Lok Sabha) of the Committee on Finance on **'Economic Impact of Revision of Natural Gas Price']**

NINTH REPORT

सत्यमेव जयते

LOK SABHA SECRETARIAT
NEW DELHI

December, 2014, Agrahayana, 1936 (Saka)

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STANDING COMMITTEE ON FINANCE
(2014-2015)

(SIXTEENTH LOK SABHA)

MINISTRY OF FINANCE
(DEPARTMENT OF REVENUE)

[Action taken by the Government on the recommendations contained in Seventy-fourth Report (Fifteenth Lok Sabha) of the Committee on Finance on **'Economic Impact of Revision of Natural Gas Price']**

Presented to Lok Sabha on 22 December, 2014

Laid in Rajya Sabha on 22 December, 2014

सत्यमेव जयते

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NEW DELHI

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CONTENTS

** Not appended in the cyclostyled copy*

COMPOSITION OF COMMITTEE ON FINANCE – 2014-15

Dr. M. Veerappa Moily - Chairperson

MEMBERS

LOK SABHA

2. Shri S.S. Ahluwalia
3. Shri Venkatesh Babu T.G.
4. Shri Sudip Bandyopadhyay
5. Shri Nishikant Dubey
6. Shri P.C. Gaddigoudar
7. Dr. Gopalakrishnan C.
8. Shri Shyama Charan Gupta
9. Shri Prataprao Jadhav
10. Shri Rattan Lal Kataria
11. Shri Bhartruhari Mahtab
12. Shri Prem Das Rai
13. Shri Rayapati Sambasiva Rao
14. Prof. Saugata Roy
15. Shri Jyotiraditya M. Scindia
16. Shri Gajendra Singh Sekhawat
17. Shri Gopal Shetty
18. Shri Anil Shirole
19. Vacant*
20. Dr. Kiritbhai Solanki
21. Dr. Kirit Somaiya

RAJYA SABHA

22. Shri Naresh Agrawal
23. Shri Naresh Gujral
24. Shri A. Navaneethakrishnan
25. Vacant**
26. Dr. Mahendra Prasad
27. Shri P. Rajeeve
28. Shri C.M. Ramesh
29. Shri Ajay Sancheti
30. Shri Digvijaya Singh
31. Dr. Manmohan Singh

SECRETARIAT

1.	Shri R.K. Jain	-	Joint Secretary
2.	Shri P.C. Koul	-	Director
3.	Shri Ramkumar Suryanarayanan	-	Additional Director
4.	Shri Kulmohan Singh Arora	-	Deputy Secretary

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* Shri Jayant Sinha, MP ceased to be Member of the Committee w.e.f. 09.11.2014 consequent upon his induction to the Union Council of Ministers

** Shri Brajesh Pathak, MP ceased to be the Member of the Committee w.e.f. 25.11.2014 consequent upon his retirement from Rajya Sabha

INTRODUCTION

I, the Chairperson of the Committee on Finance, having been authorized by the Committee, present this Ninth Report on action taken by Government on the Observations / Recommendations contained in the Seventy-fourth Report of the Committee (Fifteenth Lok Sabha) on "Economic Impact of Revision of Natural Gas Price' of the Ministry of Finance (Department of Revenue).

2. The Seventy-fourth was presented to Lok Sabha / laid on the table of Rajya Sabha on 07 August, 2013. The Action Taken Notes on the Recommendations were received from the Government *vide* their communication dated 19 February, 2014.

3. The Committee considered and adopted this Report at their sitting held on 18 December, 2014.

4. An analysis of the action taken by the Government on the recommendations contained in the Seventy-fourth Report of the Committee is given in the Appendix.

5. For facility of reference, the observations / recommendations of the Committee have been printed in bold in the body of the Report.

NEW DELHI;	**DR. M. VEERAPPA MOILY,**
18 December, 2014	**Chairperson,**
27 Agrahayana, 1936 (Saka)	**Committee on Finance.**

CHAPTER – I

REPORT

This Report of the Committee on Finance deals with action taken by Government on the Observations/Recommendations contained in their Seventy-fourth Report (Fifteenth Lok Sabha) on 'Economic Impact of Revision on Natural Gas Price' which was presented to Lok Sabha / Laid in Rajya Sabha on 7th August, 2013.

2. The Action Taken Notes were received from the Government in respect of all the three Observations/Recommendations (Recommendations at serial Nos. 2 and 3 have nine sub paras each) contained in the Report including their sub paras on 19 February, 2014. These have been analyzed and categorized as follows:

(i) Observations/Recommendations that have been accepted by the Government:

Recommendation Nos. 1, 2 (i) to (iii), 2 (vii) to (ix), 3 (i) to (ix)

(Total 16)
(Chapter II)

(ii) Observations/Recommendations which the Committee do not desire to pursue in view of the Government's replies:

Recommendation No. 2(v)

(Total 01)
(Chapter III)

(iii) Observations/Recommendations in respect of which replies of Government have not been accepted by the Committee:

Recommendation Nos. 2 (iv) and 2 (vi)

(Total 02)
(Chapter IV)

(iv) Observations/Recommendations in respect of which final replies by the Government are still awaited:

Recommendation No. Nil

(Total - Nil)
(Chapter V)

3. The Committee desire that the replies to the comments contained in Chapter I may be furnished to them expeditiously.

4. The Committee will now deal with the action taken by the Government on some of their Recommendations contained in the Report.

Recommendation [Para 2 (iv)]

5. With the view to meet the serious challenges that have arisen due to the tendency of contractors to manipulate the investment multiple parameter and controlling production, which adversely affected supply, the Committee had recommended the Government to conduct a scientific cost study in the gas basins warranting / justifying a higher price. It cannot be a mechanism only leading to windfall / super- normal profits to entities, thereby putting the cost of private profit on society.

6. The Ministry of Petroleum & Natural Gas in their Action Taken Note has stated as follows:

1. "The Gas Pricing Formula has to be determined based on provisions of PSC. The current Production Sharing Contract (PSC) has the following Provisions:

 (i) Article 21.6.1 provides that, "the Contractor shall endeavour to sell all Natural Gas produced and saved from the Contract Area at arms-length prices to the benefit of the Parties to the Contract."

 (ii) Clause 21.6.3 of the PSC provides that, "the formula or basis on which the prices shall be determined pursuant to Articles 21.6.2 (b) or (c) shall be approved by the Government prior to the sale of natural gas to the consumers / buyers. For granting this approval, Government shall take into account the prevailing policy, if any, on pricing of Natural Gas including any linkages with traded liquid fuels, and it may delegate or assign this function to a regulatory authority as and when such authority is in existence."

 (iii) The formula which was approved in 2007 for KG-DWN-98/3 was benchmarked to the international crude price, with a floor and ceiling price. Price of crude oil was capped at US $ 60 / bbl and a floor of US $ 25 / bbl. The Rangarajan Formula considered various options regarding the gas pricing formula. In the absence of competitive gas markets in India, Rangarajan Committee decided to use gas prices in various global markets as a proxy for what Indian domestic gas producers should get, so that they are not placed at a disadvantage vis-à-vis producers in other countries. By averaging gas prices across major global markets, the Rangarajan Committee formula incorporates high price formations linked to Indian LNG imports as well as Japanese imports, medium price formations in Europe and relatively low gas pricing regime in USA. This is an optimum mix, which balances various forces of supply and demand and dampens the impact of high priced Indian LNG imports as well as sporadic price spikes in regional markets. The formula reduces the possibility of producers reaping unlimited gains from price spikes by spreading the risk across a large basket of prices. It may be noted that the price of Indian LNG imports indirectly provides a cap on what Indian domestic producers can charge. Domestic gas prices based on Rangarajan Committee formula are likely to be lower than Indian LNG import prices in normal circumstances.

(iv) The issue of capping the gas price for power sector at US $ 5.0 mmbtu was raised by the Ministry of Power during the Inter Ministerial Consultation (IMC) process. MOP stated that the base Gas price for Power sector should not be more than US$ 5.0 /MMBtu and may be priced on Rupee term. MOP&NG had clearly articulated that, "the Upstream oil & gas industry is inherently risky and besides other risks there is significant investment Risk in the E&P Sector..." On the same issue it was further brought out that, "MOP has rightly observed that gas output from old nomination fields and JV fields like PMT and Raava is declining. Unless there is massive investment and technology infused in the Upstream Oil & Gas sector, domestic production of hydrocarbons will keep on dwindling."

(v) The Government's 12th Plan document states that "Energy pricing is an economically important but also politically sensitive issue. While the political sensitivity is self evident, the economic role of rational energy pricing is not adequately appreciated. Energy prices perform the important role of balancing consumer energy demand with producer supply providing incentives to reduce consumption and to stimulate production. As a general rule, energy prices should be aligned with global energy prices, especially when large imports are involved. Misalignment of energy prices poses both micro-economic and macro-economic problems."

(vi) Thus, it is the view of the Government that cap or floor on gas prices is not required to be stipulated in the new formula.

2. For the reasons elaborated above, Government does not consider it necessary to impose cap or floor on domestic gas prices under the new formula. In any case, Government has the inherent power to intervene in public interest, in case of extreme or unexpected events.

3. Regulating / monitoring of cost recovery and technical parameter related to production is being done by the Management Committee in accordance with the provisions laid down in the PSCs signed between GOI and contractors. The accounts of gas production under PSC are also subject to regular audit as per PSC. The costs recoverable and allowable have been defined in Section 3.1 of the Accounting Procedure of the PSC.

4. ONGC and OIL undertake a detailed costing exercise. The average cost of gas production for ONGC was US$3.63 / mmbtu in 2012-13. However, gas production cost by ONGC in some of its operational areas is higher than US$ 4.2 / mmbtu. OIL has its natural gas production only from

on-land areas. The cost of production of natural gas by OIL during 2012-13 was US $ 3.21 / mmbtu. ONGC fields are old and have been depreciated. The cost of production varies significantly, depending on location, geological complexity and vintage. For instance, drilling an exploratory well on land may cost upwards of US $ 2 million, while drilling a well in ultra deep water may cost US $ 100 – 150 million. A significant part of future E & P activities are envisaged in Indian offshore sedimentary basins, where E & P costs are much higher than for on-land E & P activities. It may be noted that averaging of costs across a large number of producing fields, as in the case of ONGC and OIL, can be misleading. The marginal cost is more relevant and accurate for new E&P efforts compared to average cost. The marginal cost is likely to be higher than the average cost.

5. The principle of 'Cost Plus' pricing was given up in favour of market linked pricing for petroleum products in 2002, consequent to dismantling of APM regime for petroleum products. Moreover, natural gas pricing on cost basis is not provided for in the PSC. It will not be correct to consider only the capital investment on development. The per unit cost of the gas being produced does not only have one component of development cost. There is the component of finding cost (exploration cost) which also has to be incorporated in cost calculations. At the extant gas price of US $ 4.2 / mmbtu, many of the existing discoveries will not be commercial to be developed and exploited.

6. The recommendation is being dealt with in accordance with provisions of the PSC".

7. **The Committee note that in order to align energy prices with global energy prices, the Ministry does not consider it necessary to impose cap or floor on domestic gas prices under the new formula. According to the Ministry, natural gas pricing on cost basis is not provided for in the PSC, as the per unit cost of the gas being produced does not have only one component of development cost, and the exploration cost also has to be incorporated. The Ministry have thus concluded that at the extant gas price of US $4.2/mmbtu, many of the existing discoveries will not be commercial to be developed and exploited. The Committee are of the firm opinion that it is also important to have a policy regime that ensures remunerative price to gas producers as well in order to stimulate fresh investments in the sector. Simultaneously the Committee also desire that all the actions of the Government should be dictated by "public interest" and they should devise**

an optimum pricing formula, which is fair to all stakeholders and also safeguards the long term interest of economy.

Recommendation [Para No. 2(vi)]

8. The Committee had recommended that any fixing of input price at a lower level than output price will mean a bloating of subsidies; is the government prepared for a disproportionately higher subsidy outgo in successive budgets for the fertilizer and power sectors and whether this has been factored in the 12th Plan. The extent of its inflationary impact needs to be considered".

9. The Ministry of Petroleum & Natural Gas in their Action Taken Note have stated as that these aspects have been taken into consideration by the Government while approving Natural Gas Pricing Guidelines, 2014.

The Department of Fertilizers in their Action Taken Note have stated that the increase in price of Gas will skyrocket the subsidy burden on the exchequer as it is important to note that there is a direct impact of rise in gas price on the prices of fertilizers as increase in the price of gas by Rs.1.00 per MMBTU results in the increase of the cost of production of urea by Rs.24.893. Therefore, the additional liability of subsidy towards domestic urea would be Rs.24.893/MT of urea approximately. On an average in India around 24.893 MMBTU of natural gas is required to produce one MT urea. If gas price increase by $1/MMBTU, per MT increase in production cost of urea will be 24.9x1x55=Rs.1369.5MT. Therefore, an increase of USD 1/MMBTU translates to enhanced cost of production of about (55x24.9=1369) Rs.1369/MT of urea. Increasing gas price by USD 1/MMBTU translates in enhanced cost of almost Rs.2465.1 crores for 18MMT of urea produce by gas based units per annum (1x24.9x55x180/100=2465.1crorres/ annum). It will further increase the cost of production for another 5MMT of Urea being produced by Naphtha/ FO/LHSH units which are going to convert to gas during next one year. The impact of the same on this 5MMT would be 770 crores/ annum (1x28x55x50/1000). The entire impact of increase in gas price would be on subsidy outgo as the MRP of urea is statutorily controlled.

10. The Committee note that the proposed increase in price of gas will heighten the subsidy burden on the exchequer, as the MRP of urea is statutorily controlled. The Committee further note with satisfaction that the Government while approving National Gas Pricing Guidelines, 2014 have taken all these aspects into consideration.

Recommendation [Para No. 3(i)]

11. The Committee had recommended that at this juncture of our economic development, transitioning from a regulated to a fully market-based system should be staggered.

12. The Ministry of Petroleum & Natural Gas in their Action Taken Note have stated as follows :-

> 1. "Ministry agrees with the recommendation that movement to a fully market based system for domestic gas produced should be staggered. Rangarajan Committee recommends (Para 24.2.1) that it may not be feasible to introduce gas-on-gas competition (i.e. market based system) at this juncture. Therefore, the Report has provided a policy prescription for moderating pricing power of the producers of natural gas, till such time when gas-on-gas competition becomes feasible. Expansion of infrastructure for LNG / pipeline networks and further increase in domestic production will make transition to gas-on-gas competition feasible. The Report recommends that Government review the situation after five years, based on evolution of gas markets in India.
>
> 2. Government approval for Natural Gas Pricing Guidelines, 2014 is in accordance with the recommendations of the Standing Committee. The Natural Gas Pricing Guidelines, 2014, effective from 01.04.2014 will be applicable for five (5) years. The road map for transition to a fully market based system will be worked out during this period, as feasible".

13. The Committee note that the Government has agreed in principle with their recommendation that movement to a fully market based system for domestically produced gas should be staggered. The Natural Gas Pricing Guidelines, 2014 brought out by the Government are also in accordance with the Recommendation of the Committee. Now that these Guidelines provide a window of five years the Government should work out an interim mechanism after consulting all stakeholders for domestically produced gas, till such time when gas-on-gas competition becomes feasible in the country.

Recommendation [Para No. 3 (vi)]

14. The Committee had recommended that the important recommendation of the Rangarajan panel of moving to a revenue-sharing arrangement with gas producers should be considered. A new Production Sharing Contract (PSC) model should be evolved that will do away with incentives to control production and manipulating investments, while assuring reasonable returns to the producers.

15. The Ministry of Petroleum & Natural Gas in their Action Taken Note have stated that the recommendation has been approved by MOPNG and is under Inter Ministerial Consultation.

16. The Committee note that the recommendation of Rangarajan panel of moving to a revenue sharing arrangement with gas producers has been approved by Ministry of Petroleum and Natural Gas and is under Inter-Ministerial Consultation. The Committee reiterate their recommendation that while taking a final call to raise gas prices, the Government should adopt a balanced pricing formula which is closely related to the audited cost of production which already includes a reasonable return on the capital invested.

New Delhi;	**DR. M. VEERAPPA MOILY,**
18 December, 2014	**Chairperson,**
27 Agrahayana, 1936 (Saka)	**Committee on Finance.**

Minutes of the Fourteenth Sitting of the Committee on Finance
The Committee sat on Thursday, the 18th December, 2014 from 1500 hrs. to 1715 hrs. in Committee Room 'B', Ground Floor, Parliament House Annexe, New Delhi.

PRESENT

Dr. M. Veerappa Moily – Chairperson

MEMBERS

LOK SABHA

2. Shri Venkatesh Babu T.G.
3. Shri Nishikant Dubey
4. Dr. Gopalakrishnan C.
5. Shri Shyama Charan Gupta
6. Shri Rattan Lal Kataria
7. Shri Bhartruhari Mahtab
8. Shri Gajendra Singh Sekhawat
9. Shri Gopal Shetty
10. Shri Anil Shirole
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13. Dr. Mahendra Prasad
14. Shri C.M. Ramesh
15. Shri Ajay Sancheti
16. Dr. Manmohan Singh

SECRETARIAT

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2. Shri P.C. Koul	-	Director
3. Shri R.K. Suryanarayanan	-	Additional Director
4. Shri Kulmohan Singh Arora	-	Deputy Secretary

WITNESSES

2. x x x x x
3. x x x x x

4. x x x x x
5. x x x x x

(The witnesses then withdrew)

6. Thereafter the Committee took up following draft Reports for consideration: -

(i) Draft Report on Demands for Grants (2014-15) of the Ministry of Planning:
(ii) Memorandum No. 4 regarding draft Report on action taken by the Government on the Observations / Recommendations contained in the Fifty-ninth Report (Fifteenth Lok Sabha) on the subject 'Current Economic Situation and Policy Options'; and
(iii) Memorandum No. 5 regarding draft Report on action taken by the Government on the Observations/Recommendations contained in the Seventy-fourth Report (Fifteenth Lok Sabha) on the Subject 'Economic Impact of Revision of Natural Gas Price'.

7. After some deliberations, the Committee adopted the above draft Reports with minor modifications in the Reports mentioned at Sl. Nos. (i) to (iii) above and authorised the Chairperson to finalise them in the light of factual verification from concerned Ministries/Departments.

The Committee then adjourned.

A verbatim Record of the proceedings has been kept.

APPENDIX

(Vide Para 4 of the Introduction)

ANALYSIS OF ACTION TAKEN BY THE GOVERNMENT ON THE RECOMMENDATIONS CONTAINED IN THE SEVENTY-FOURTH REPORT OF THE COMMITTEE ON FINANCE (FIFTEENTH LOK SABHA) ON 'ECONOMIC IMPACT OF REVISION OF NATURAL GAS PRICE' OF THE MINISTRY OF FINANCE (DEPARTMENT OF REVENUE)

		Total	% of total
(i)	Total number of Recommendations	19	
(ii)	Recommendations/Observations which have been accepted by the Government (Vide Recommendation at Sl. Nos.1,2(i) to (iii),2(vii) to (ix), 3(i) to (ix))	16	84.21%
(iii)	Recommendations/Observations which the Committee do not desire to pursue in view of the Government's replies (Vide Recommendation at Sl. No. 2(v)	01	5.26%
(iv)	Recommendations/Observations in respect of which replies of the Government have not been accepted by the Committee (Vide Recommendations at Sl. Nos.2(iv) and 2(vi))	02	10.53%
(v)	Recommendations/Observations in respect of which final reply of the Government are still awaited	Nil	0%