

● OVERCOMING THE FISCAL CHALLENGE

GST to lead the development of a natural gas hub

A standardised and uniform tax structure such as GST for natural gas will rationalise pricing and make spot market discovered prices relevant to the stakeholders. It will also provide much-needed fillip to the development of support infrastructure—pipelines, storage and re-gasification capacities

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THE ACHILLES' HEEL of increasing the share of natural gas in India's energy demand remains its relative pricing and access to pipelines and infrastructure. So far, natural gas prices have been linked to crude oil prices or indices of crude oil basket. However, over the last two years or so, the relationship between crude oil and natural gas went for a toss due to three reasons.

One, with crude oil becoming cheaper, natural gas—which was traditionally traded in regional pockets—became cost-efficiently movable to buyers located at farther places across the globe. An example of this is the recent purchase of US-origin liquefied natural gas (LNG) by GAIL India from Cheniere Energy's liquefaction facility in the Henry Hub in the US.

Two, the increasing levels of domestic re-gasification capacities have been lending support to increased imports of the supercooled LNG. As a result, during the last decade, the surplus producers such as the Middle East, the US and Russia were able to ship bulk of their production, mainly to populous Asia, making the continent the largest market for LNG.

And three, with lower natural gas prices, increasing supplies and the thrust for greener/cleaner fuels, consumers made a conscious choice towards natural gas as the preferred source of energy over other alternatives, and drew a slew of investment towards the development of technologies that made natural gas the fuel of

choice in terms of cost-effectiveness across various uses.

With crude oil prices going through the roof, as has happened in the recent times, natural gas pricing has the possibility of realigning with the crude markets once again, given its substitutability. Such a scenario of gas markets indexing to crude oil makes it all the more essential for the efforts of densely-inhabited countries like India, with ambitions to promote clean energy for fuelling its economic growth; India should resort to development of well-participated local markets for natural gas, facilitated by strong private investments in pipeline infrastructure spread across the nook and corners of the country. In fact, private investments in infrastructure will follow liberalisation of market forces. Market and its development hinges on gas pricing becoming relevant to the stakeholders spread across the geography. With gas being substitutable across most user industries, clear pricing becomes the need of the hour for the growth and development of natural gas usage in the country. While the creation of a gas hub will make available daily pricing trends out of a given benchmark place of gas delivery of a physical hub, its usage will depend upon the final cost, which will include transportation and taxes. As of today, the state taxes on natural gas vary between 4% and 25%, which could lead to unjust access to natural gas and, hence, unequal economic opportunities.

While an electronic online auction market in the hub may provide a bench-

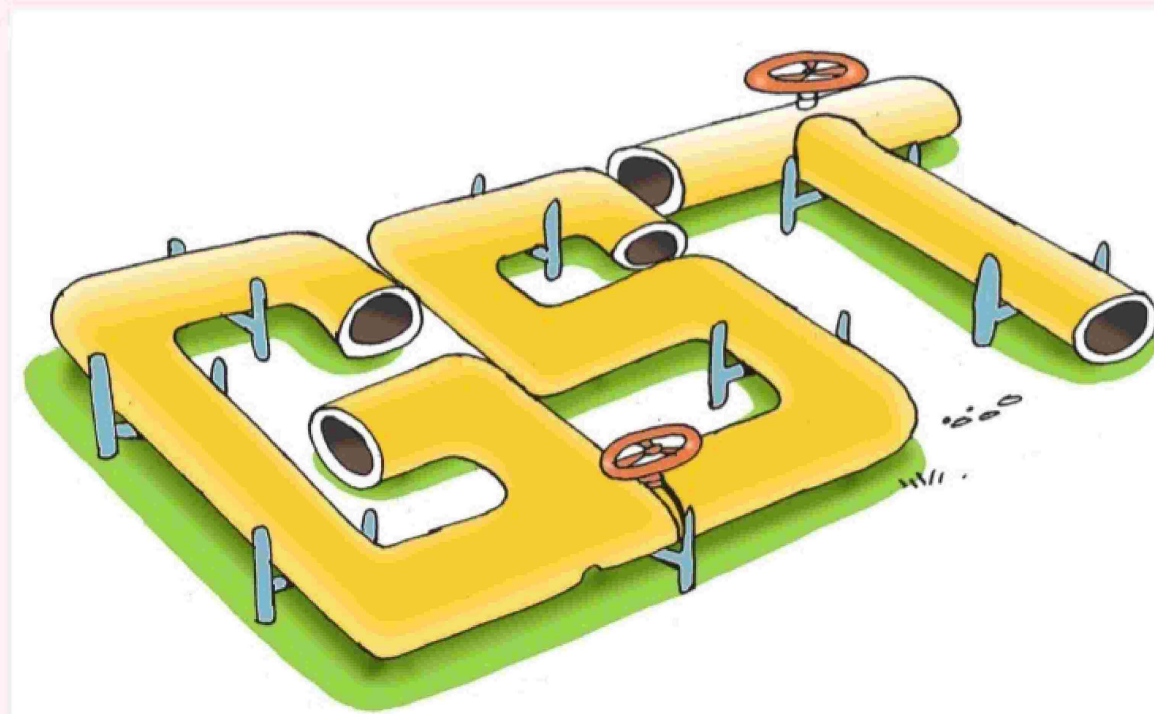


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LPG, coal and fuel oil have been included in GST and they benefit from a standardised tax rate of 5%. Natural gas, a key energy product for several industries, should also be brought under its ambit

mark price for various transactions, its relevance will depend upon the ability of the stakeholders to access natural gas at expected prices and provide compet-

itive products/services. Further, varied taxes, as applicable today across various states, have the potential to gradually shift energy-oriented businesses to states with lower taxes from states that levy higher taxes to take advantage of low-cost energy.

The implementation of GST, as in other commodities, will help the spot hub provide uniform prices to the consumers across the national geography, with the only variability being transportation. Additionally, GST on natural gas will provide for proficiency in energy-based industries by enabling users to receive payback of GST paid on natural gas while selling their products

or services covered under GST regime and, thereby, avoid multiple incidences of taxes on the end-users of energy. It will bring in efficiency and competitiveness among the users of natural gas and, thereby, strengthen domestic businesses and enhance their export competitiveness.

Finally, the gas trading hubs, physical or virtual, provide price transparency in the market by fostering trading activities and determine the best price, given the supply and demand economics, without bothering about multiple mandatory charges. The multiplicity of mandatory charges, as currently levied on natural gas, would potentially

divert the participants in price discovery from the fundamentals. A liquid and transparent gas spot market allows participants to not only adjust their physical volumes based on prices, but also helps create financial products for price risk management. Natural gas with market-determined prices will help not only attract more private investments in distribution/transportation infrastructure, but also in exploration & production (E&P) activities that help enhance domestic production and strike a better balance between domestic production and imports.

The success of a hub is primarily dependent upon getting the physical aspects correct; in other words, the foundation of a successful hub begins with defining an entry-exit zone through a well-designed and functional pipeline connectivity with non-discriminatory access and balancing services. Once the foundation is in place, a well-developed spot market will help in development of a sound financial marketplace. However, without the uniform tax structure on a pan-India basis, the merits of a hub-based benchmark price will be nullified, taking the natural gas market developmental aspirations to square one.

The disparity in tax structure ultimately affects the final consumer price of gas and, as a result, the end-users end up paying different prices based on the state. The non-uniformity in the sales tax is bound to distort end-user prices and, thereby, create tax arbitrage opportunities for businesses. To overcome this, natural gas transmission companies, end-users as well as the oil ministry have been in favour of bringing natural gas under the ambit of GST, and that too under the lowest possible rate. Given that similar or alternative fuels such as liquefied petroleum gas (LPG), coal and fuel oil have been included in GST and they benefit from a standardised tax rate of 5%, therefore natural gas, which is a key energy product for several industries, should also be brought under the ambit of GST. Further, the share of contribution of natural gas to state revenue, as compared with other transportation fuels such as petrol and diesel, is not substantial and, therefore, a shift to GST may not have a significant revenue effect on the balance sheets of states.

A standardised and uniform tax structure such as GST for natural gas will aid in rationalising pricing and making spot market discovered prices relevant to the stakeholders across the nation, besides providing much-needed fillip to the growth and development of support infrastructure, including pipelines, storage and re-gasification capacities.