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The Petrol Crisis

About IPR

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The country is in the grip of shortages**.** First it was the electricity shortage, then the gas shortage and now the petrol shortage. The petrol shortage has been concentrated in Punjab which accounts for more than half the consumption of petrol in the country. The contradiction is that this shortage has come at a time when there is a global glut of oil and the international price of oil has plummeted.

Energy security is a vital dimension of human security. The decline in energy security has serious implications on various activities including production and distribution of essential goods and access to basic services. It fundamentally affects the quality of life of people. It is indeed tragic that just at the time when petrol has become more affordable, the people have been deprived of normal consumption of the product.

Why has the petrol crisis occurred? It is the consequence of deep structural problems in the energy sector which have spilled over to the shortage of petrol. This has been compounded by serious problems of co-ordination among the multitude of ministries and agencies performing different functions within the sector. What we have seen is a very serious governance failure.

The increased gap between supply and demand is due to a number of factors coming together at the same time. First, the level of imports of petrol has remained unchanged at a time when the price was falling. These imports cater for almost 52% of the consumption. The import price of petrol started falling from September onwards. By the beginning of January the international price of oil had declined by 51%. The corresponding decrease in the domestic price is 28%. A further price reduction is forthcoming.

The major importer of petroleum products is the state-owned Pakistan State Oil (PSO). It imports 66% of the petrol with the remainder 34%, being imported by other oil marketing companies (OMCs). Imports of petrol have grown rapidly in previous years. In the quarter October to December 2013, the growth of imports in comparison to the previous quarter was as high as 16%. But in the quarter October to December 2014, there has been zero growth.

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Why have imports remained stagnant in recent months? The answer lies primarily in the liquidity problems of PSO because of non-payment for purchases of furnace oil largely by the GENCOs, HUBCO and KEPCO. By September 2014 the receivables of PSO had risen to the colossal figure of Rs 222 billion. In December a number of L/Cs of PSO have been dishonored. This has greatly restricted PSO's ability to import all petroleum products. In effect, a large part of the circular debt has been parked in PSO.

The impact on import of furnace oil has been even greater. It fell by over 50% in the last quarter. This is attributable to the fact that the share of PSO in the import of furnace oil is higher at 91% as compared to the share of 66% in the case of petrol.

The domestic refineries have increased the production of petrol by about 8% in the period October to December as compared to the previous quarter. But there has been some depletion of inventories of petrol with OMCs. These companies have carried inventories to below the level of three weeks in order to minimize potential inventory losses of upto Rs 7 billion at a time of falling prices. Overall, the availability of petrol in the country has declined.

The decline in supply of petrol has occurred at a time of a big increase in demand due to a number of factors. First, the big fall in price was bound to lead to some rise in demand. In most countries a 10% fall in price of petrol is accompanied by a 2 to 3% increase in demand. By the beginning of January, with the cumulative fall in price of 28%, the increase in demand was likely in the range of 6% to 8%.

There is an additional reason for increased demand for petrol in Punjab. The Government announced the closure of CNG stations from Mid-November for four months in the Province. This has led to diversion of demand towards petrol. A first estimate is that the consequential increase in demand nationally for petrol is over 10%. Overall, a conservative estimate of the combined effect on demand of the fall in price and reduction in supply of CNG is 16%. Allowing for further price reduction, the demand for petrol will go up to about 16200 tons per day in the country. The proposed increase to 15000 tons is not enough.

Therefore, with declining supply in the presence of a big increase in demand, it was inevitable that sooner or later, a shortage would take place. The crisis could only have been prevented if the Government had anticipated and taken measures early to import more petrol, prevent a depletion of stocks and manage demand better.

IPR's assessment is that the highest contribution to the petrol crisis was the strained liquidity position of PSO which severely restricted its ability to import. This is followed in importance by the depletion of inventories, closure of CNG stations in Punjab and rise in demand due to fall in prices. Also, it is not surprising that the crisis first manifested itself in the largest Province which was due to the additional factor of closure of CNG station

As of the 23rd of January, the supply position of petrol has improved, especially in Lahore. It is not clear how the increased supply has taken place. If this is a result of diversion from the rest of the country or from other unspecified sources, then this could spread the shortage while reducing its intensity. Clearly, a permanent solution has to be found quickly.

Also, there is another shortage waiting to happen. The total import of furnace oil has fallen sharply. It was 51% lower in the last quarter as compared to the first quarter of 2014-15. Since PSO has a share of 91% in the import of furnace oil, the constrained ability to import has had a greater impact on the overall availability of furnace oil. Inclusive of domestic production, the supply of furnace oil has fallen by 36%. Consequently, the likelihood of even more power load shedding is much higher today.

Besides ensuring accountability for the debacle of different ministries and agencies, there is need for coordinated and urgent action on the part of the government on a number of fronts. First, there has to be an immediate injection of funds into PSO by the Ministry of Finance of up to Rs 100 billion. Second, the problem of mounting circular debt has to be tackled much more vigorously by the Ministry of Water and Power to ensure that PSO does not find itself in the same crippled position once again. Third, OGRA may consider raising the required level of stocks with OMCs to at least one month's cover and develop an adequate monitoring mechanism with penalties. Fourth, the gap between price revisions is too long at one month. It may be reduced to one week initially and eventually prices of petroleum products may be deregulated fully. The role of the Competition Commission of Pakistan must be to prevent the emergence of any cartels. Finally, the Ministry of Petroleum and Natural Resources must develop the capacity to forecast and monitor supply and demand better and play a more aggressive management role within the petroleum sector.