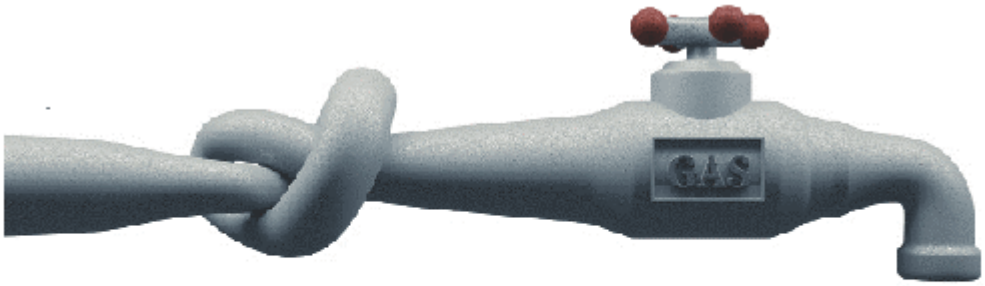
DAWN

CORPORATE WINDOW: Untangling the gas sector

Afia Malik | 06th Jan, 2025



A lack of sustainable solutions marks the entire energy landscape; whether it is the electricity, gas, or petroleum sector, the story is more or less the same. The circular debt of the gas sector has reached Rs2.89 trillion, including Rs0.81tr interest, according to the energy ministry cited in the print media as of September 2024.

As per official figures, the debt was reduced temporarily to Rs2.1tr in January 2024, owing to the exemplary increase in consumer-end tariffs for non-subsidised categories, but increased again to September 2023 levels.

In Pakistan, 47 per cent of gas comes from indigenous gas fields using the Sui transmission network and 23pc from regasified liquefied natural gas (RLNG) imports. Moreover, about 30pc of low British thermal unit (BTU)

indigenous gas comes from independent dedicated fields and is supplied directly to some fertiliser and power plants.

RLNG prices — determined independently for Sui Northern Gas Pipelines Limited (SNGPL) and Sui Southern Gas Company Limited (SSGCL) — are significantly higher than those of indigenous gas. In September 2024, SNGPL's RLNG cost $13.86 per million metric British thermal units (MMBTU), while SSGCL's cost $13.42 per MMBTU. In contrast, the price for indigenous gas through the Sui network (disregarding low BTU gas) was $5.60 per MMBTU.

Gas allocation policy, driven by political priorities, results in deadweight loss, rising circular debt, and inefficient use of valuable natural resources

After remaining stagnant for over a decade, gas production from indigenous fields has been declining since FY20 due to limited activities in the exploration and production (E&P) business. Since FY15, we have relied on imported RLNG. Due to distorted pricing and allocation policies, the E&P companies struggle to undertake large-scale exploration activities, as they have significant receivables from Sui companies and power producers.

Prioritising payments for RLNG imports over those for domestic producers creates a cycle of debt within the sector, ultimately undermining incentives for the domestic E&P sector.

For example, as of June 1, 2024, the receivables from SNGPL for Pakistan State Oil (PSO) and Pakistan LNG Limited (PLL) amounted to Rs0.54tr and Rs0.15tr, respectively. Delays in payments from SNGPL caused liquidity issues for PSO. To prevent PSO from defaulting, SNGPL prioritises these payments, which results in delayed payments to E&P companies — Oil and Gas Development Company (Rs0.81tr) and PPL (Rs0.89tr).

Additionally, to regulate gas pressure in the pipeline distribution system, local gas flow from fields has also been reduced when there is surplus RLNG due to less offtake in the power sector, discouraging the country's E&P companies.

Pakistan began importing RLNG primarily for the power sector, which is also a key RLNG consumer. In the power sector, the economic merit order (EMO) for purchasing electricity from various generation sources does not consider the contractual, financial, and operational requirements of RLNG supplies. In EMO, priority is given to low-cost generation, irrespective of the idle capacity of RLNG plants and the idle supply of expensive RLNG.

Prioritising low-cost power generation to reduce fuel expenses can lead to under-utilising expensive RLNG plants (with take-or-pay contracts), resulting in capacity payment obligations even when these plants are not in operation. Thus, increasing consumer tariffs also leads to circular debt buildup in the power sector. This highlights the need for integrated energy planning.

The gas sector is burdened with circular debt due to an ineffective tariff design — cross-subsidy across sectors. Up to 70pc of the domestic gas consumption is in the subsidised slabs, besides a few other sectors, like special commercial.

Substantial government involvement in the RLNG supply chain and political preference for gas distribution make recovering gas/RLNG costs challenging; due to the flawed planning, excess RLNG is diverted to the subsidised domestic sector instead of productive sectors.

Hence, cross-subsidisation, where more efficient gas consumers — such as industry or high-end domestic users — shoulder the financial burden of less efficient counterparts, has inadvertently created a system that rewards inefficiency and conceals operational shortcomings.

The gas sector lacks competition across upstream, midstream, and downstream segments. Monopolies SNGPL and SSGCL are expanding their networks to boost revenues despite a 17pc decline in gas production from FY19 to FY23. Meanwhile, their transmission and distribution assets increased by 11pc. By adding new connections, these companies augment their fixed assets, as they are assured a market-based return of 16.6pc on their net operating fixed assets.

Pakistan's natural gas network is inefficient and reflects short-sighted energy policies. Besides, regulatory ineffectiveness — delays in decisions on late payment surcharges, RLNG diversion costs, and RLNG cost actualisation is causing significant revenue losses for companies and increasing circular debt.

In February 2022, the Senate approved the Weighted Average Cost of Gas bill to address pricing disparities between RLNG and local gas to ensure accurate pricing for consumers. However, the bill has not yet been implemented.

Gas allocation policy, driven by political priorities, results in deadweight loss, rising circular debt, and inefficient use of valuable natural resources. Pakistan's lack of integrated energy planning and the influence of political considerations on gas pricing has made ours a gas-intense country. Unlike many countries that provide a single energy source to households, Pakistan offers both power and gas at subsidised rates, creating inefficiencies.

The open-access regime is vital for deregulating state-owned monopolies. By liberalising the natural gas sector and its pricing, Pakistan can create a more efficient market, improve service quality, and attract investment.

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