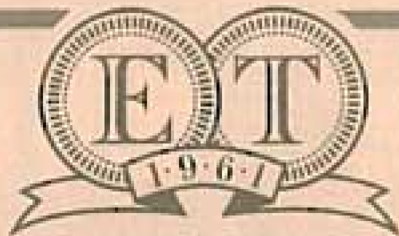
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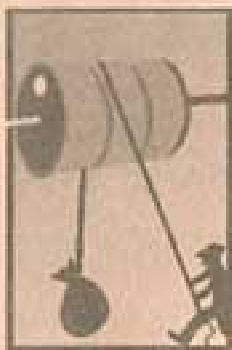
Anomalies in feedstock pricing

UTTAM GUPTA



Two years ago, the fertiliser industry got a shock when the government decided to dismantle confessional price regime for liquid hydrocarbons from September 1997, and put in place a system of uniform pricing based on import parity (IMPP). This resulted in steep increase in prices; for instance, the ex-refinery price of naphtha jumped from Rs 4,840 per tonne to Rs 7,624 per tonne.

Thanks to prevailing low international prices during 1998-99, domestic prices were low. By the beginning of the current year, ex-refinery price of naphtha was Rs 6,820 per tonne. Since then, the price has skyrocketed. Currently, this is Rs 11,680 per tonne at port locations. On supplies to users located inland, this is even higher; for instance, the ex-Mathura price is Rs 12,250 per tonne.

Given the euphoria of globalisation gripping the entire economy including the petroleum sector, users dare not talk of the reasonable production cost approach (pricing on so-called confessional basis is unimaginable). However, they do have a right to know whether pricing on the principle of IMPP is being done in the true spirit? The fact of the matter is, it is not.

The basis followed by oil companies is the cost of imports, i.e., C&F cost (this includes FOB price and ocean freight) plus various costs incurred at the port like unloading, clearing and forwarding charges, demurrage/wharfage, facility charges and so on. Following this method, the cost of naphtha delivered at Indian ports is about Rs 10,530 per tonne (corresponding to FOB price of US $214.0 per tonne average for September/October 1999).

The oil companies add a further Rs 1,150 per tonne towards marketing margin to arrive at the ex-refinery price charged to the users at port locations of Rs 11,680 per tonne. If the user had imported naphtha — instead of procuring it from the oil companies — he would have incurred only Rs 10,530 per tonne.

This is a distortion of the concept of international price parity. To be meaningful, the latter is represented by realisation from exporting the product. In turn, this is arrived at by deducting from the FOB price ocean freight and various expenses incurred at the port. Incidentally, this is also the money realised by oil companies in the exporting countries from sale of their product in the world market.

On the above basis and taking prevailing FOB price of naphtha as US $214 per tonne, the net-back at Indian port will work out to about Rs 8,350 per tonne. The ex-refinery price should be fixed at this level only instead of Rs 11,680 per tonne currently charged by oil companies.

In other words, if IMPP principle is followed in true spirit, the price to users would have been lower by Rs 3,330 per tonne (11,680 - 8350).

The above would yield a reduction in production cost of urea by about Rs 2,330 per tonne (taking 0.7 tonnes naphtha for a tonne of urea). On total urea production of about 5.0 million tonnes by naphtha based plants, this in turn, would result in unprecedented savings in subsidy of about Rs 1,200 crore per annum.

Thus, we have an anomalous situation whereby, oil companies unjustifiably boost their profits — thereby getting accolades from all over — by distorting even the principle (read IMPP) laid down by the government, and the fertiliser industry is often criticised for consequential increase in subsidy.

In the context of contemplated phased de-regulation of fertiliser sector, the minister for chemicals and fertilisers has emphasised the need for proper pricing of feedstock for the fertiliser industry.

Towards this end, the oil companies which are by and large, owned and controlled by the government, should be persuaded to correct the anomalies in the existing method of determining ex-refinery prices.

(Dr Gupta is chief economist, The Fertiliser Association of India)