Contemplated revival of duty on project imports — a retrograde step

Uttam Gupta

AS PER recent press reports, the government is contemplating revival of duty on fertilizer project imports — besides import of projects for setting up refineries, power plants — as part of the overall thrust on maintaining a certain "floor" import duty.

Levy of import duty as against 'nil' at present will lead to substantial increase in project cost and, consequently, increase in reasonable cost of production by way of corresponding increase in capital related charges (CRC). In the face of control on the selling price of urea at a low level, this would lead to a corresponding increase in subsidy.

In the case of decontrolled phosphatic and potassic fertilizers, higher cost of production from new units will require increase in concession support — under the scheme of ad hoc concession — in order to maintain selling prices to farmers at affordable levels. If this is not allowed, it will affect the viability of producers.

To get an idea of the extent of impact, consider a new grassroots ammonia/urea project having capacity of 0.768 million tonnes per annum urea. Let investment cost be Rs 1,500 crores of which import content is one third or Rs 500 crores. Now, assume that customs duty is levied @ 10 per cent ad valorem. The duty amount will thus be Rs 50 crores.

The project cost will, however, increase by this much plus interest during construction. Generally, it takes about three years to complete the project from zero date provided there are no delays in implementation. On this basis, @ 15 per cent per annum, interest amount would be about Rs 26 crore (compounded over the three year period). Consequently, the effective increase in project cost will be Rs 76 crores.

This is financed generally in the same debt-equity ratio as total project cost. For a project in the public/cooperative sector, this is 1:1 or Rs 38 crores from loan and equity each. For projects in the private sector, this would be 2:1 or above, depending on the perception of financial institutions (FIs) and the exposure they are willing to take.

Under the retention pricing scheme (RPS), while interest on loan is reimbursed as per actual, i.e., 15 per cent, on equity, pretax return of 18.46 per cent corresponding to 12 per cent posttax is allowed (taking the prevailing rate of corporate tax at 35 per cent). Thus, additional outgo towards interest/return would be Rs 12.72 crore (38 x 0.15 + 38 x 0.1846).

In addition, the cost towards depreciation on plant and machinery has also to be allowed. At the current rate of 6.33 per cent (corresponding to 15 years life) on Rs 76 crores, this works out to Rs 4.8 crores. Thus, all put together, increase in CRC on account of the duty would be Rs 17.52 crores.

For the purpose of reimbursement to the manufacturer, this amount is divided by the normative production level to give per unit rate. In the case of a gas based plant, the latter being 90 per cent of capacity or 0.691 million tonnes, the retention price of a new project would thus be higher by Rs 254 per tonne. Needless to say that this additional outgo will be recurring.

In view of the above, introduction of customs duty on fertilizer project imports will run contrary to the avowed goal of containing/reducing fertilizer subsidy which has even prompted the government to take various measures, under RPS, in the past adversely affecting the profitability of manufacturing units and even vitiating the climate for further investments.

Even the one time inflow of revenue by way of duty, i.e., Rs 50 crore in the instant example, is illusory. This is because for projects in the public/cooperative sector, an amount substantially higher than the duty, i.e., Rs 76 cores, has to be pumped in to finance the consequential increase in project cost. Even for private sector projects, the funds have to come from government owned/controlled FIs/commercial banks.

For procuring plant and machinery for any new project or the one which is granted substantial expansion status, it is mandatory for the company to go for international competitive bidding (ICB). While this gives equal opportunity to both the Indian and foreign suppliers, the former enjoy deemed export benefits besides, exemption from excise duty. Specifically, import of raw materials and consumables are exempt from levy of customs duty. Moreover, they get SIL (special import license) equivalent to 6 per cent of the value of the order.

For indigenous suppliers various tax elements are zero excise duty and 4 per cent CST on indigenous raw materials; the net incidence of this, however, is 3 per cent (as these account for about 75 per cent of total cost) and another 4 per cent towards CST on sale of plant/machinery to end users. That gives a total of 7.0 per cent. From this, take off the benefit of premium on SIL (about 0.6 per cent), and the net burden would be 6.4 per cent.

As against the above, on project imports, while customs duty is nil and no local taxes have to be paid either, there are costs towards ocean freight about 5 per cent, all risk marine insurance 1 per cent and wharfage, port trust and customs clearance another 2 per cent. That adds up to total incidence of 8 per cent.

It also important to note that presently fertilizer project imports are exempt from levy of special duty 5 per cent and additional special duty 4 per cent. This is because basic customs duty is zero. Once, the duty is revived, special/add special duty will follow automatically. That would virtually tantamount to eliminating competition and denying user industries the opportunity of procuring plant and machinery at low cost.

There has been considerable vacillation in the government's approach towards levy of duty on fertilizer project imports. In the early 1980s, this was a high of 40 per cent ad valorem. Based on the recommendation of the economic administrative reforms commission (EARC), with effect from. March 1,1985, this was completely eliminated. However, w.e.f. March 1, 1987, this was revived @ 15 per cent.

Thereafter based on the recommendations of the JPC (1992), the duty was reduced to nil in August, 1992. Concurrently, the government also abolished duty on import of plant and machinery for implementing debottlenecking, revamp and modernization of existing fertilizer units.

Additionally, for projects set up after January, 1991, which had imported their plant and machinery having paid customs duty at the prevailing rate until August, 1992, the government brought in a scheme in February, 1993, providing for refund of customs duty paid by these units.

While the above has enabled significant reduction in the cost of the projects that came up subsequent to August, 1992, with consequential benefits by way corresponding reduction in subsidy outgo, the contemplated move to reintroduce the duty will be a retrograde step.

The government should not proceed with its plans to put duty on fertilizer project imports in view of its serious implications on the subsidy outgo on urea and the viability of the manufacturers of decontrolled P and K fertilizers.

(Uttam Gupta is chief economist at the Fertilizer Association of India, New Delhi)