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Crippled by soaring feedstock cost

Dismantling of RPS and allowing free imports will not only be unfair to producers, but also, imprudent from national angle, says **Uttam Gupta**

At a recently held Seminar in New Delhi, several economists recommended scrapping of retention pricing scheme (RPS) for urea and encouraging imports which are cheaper. They hoped that even after this, it might still be possible for industry to grow in a reasonably healthy fashion. What is wrong with RPS?

The charge against it is that it scuttles competition between domestic manufacturers and with imports. This may be true as under it, every producer is allowed a fair ex-factory price — commonly known as retention price (RP) — to cover its reasonable cost of production (subject to prescribed efficiency norms) including a margin of profit, currently, 12 per cent post-tax on networth. Considering widely varying cost from unit to unit, each is allowed RP specific to it. Thus, there are 34 RPs being number of urea producing plants in the country.

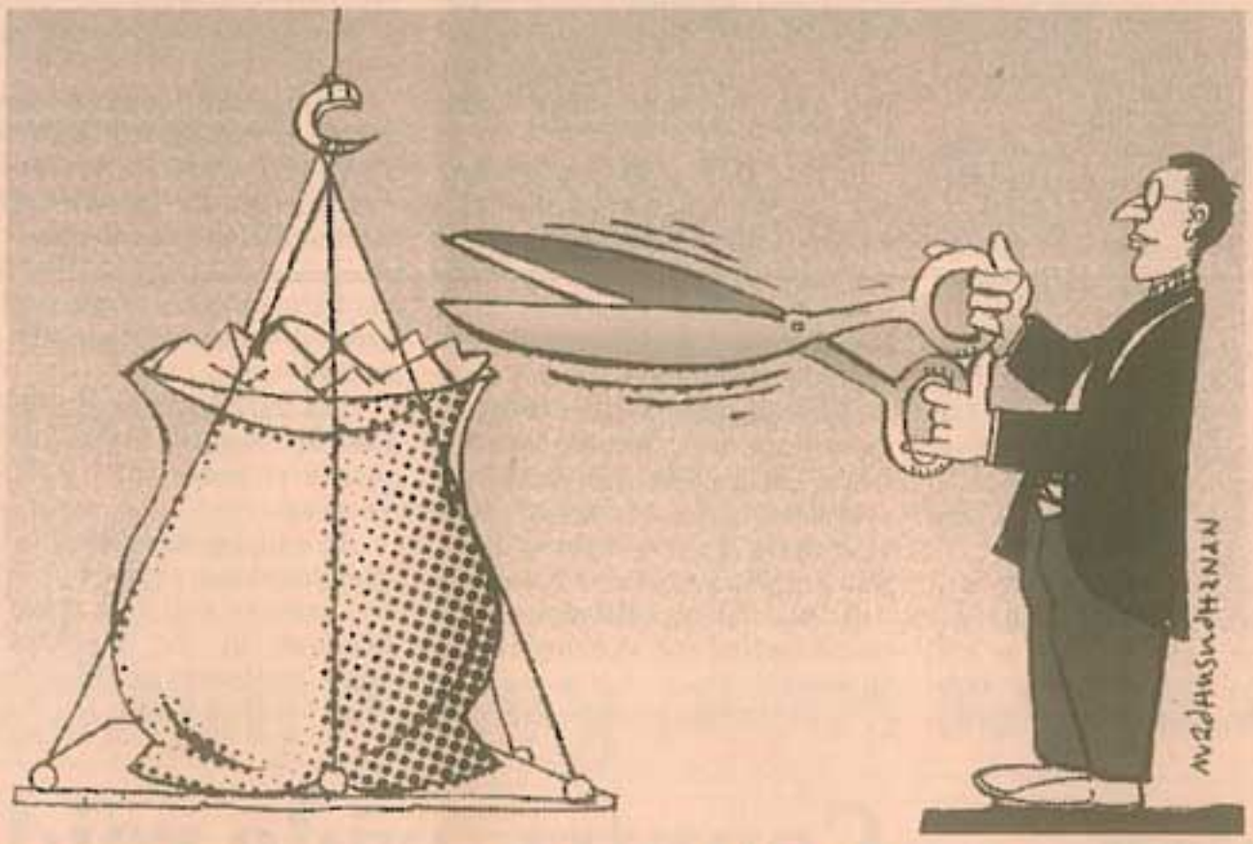
Urea is sold to farmers at a uniform controlled price, presently Rs 3660 per tonne. And, since, this is lower than RP of all plants — for majority of them, even feedstock cost is not covered — excess is reimbursed as subsidy to each producer. The cost of moving material from factory to consumption point is separately reimbursed as equated freight. The system thus, protects viability of every unit so long as it is operating at prescribed efficiency norms.

The objective of competition is to bring down production cost thus, facilitating supplies to consumers at low price. If, this can be achieved without effecting viability of efficient plants — there is no sympathy for inefficient guys — it would be a win win situation for all as apart from farmers getting urea cheap, even exchequer would benefit by way of lower subsidy or perhaps, no subsidy at all.

A vital question, in this context, is as to why production costs in India are higher than abroad and within industry also, why do these vary from unit to unit? Feedstock is main input supplying hydrocarbon for reaction in main process plant as well as source of fuel. It is the most important element in production cost accounting for about 70-80 per cent for an old vintage plant and 50-60 per cent for a new unit.

About 70 per cent of nitrogen capacity worldwide is based on natural gas, bulk of this being from old and depreciated plants. In Middle East, FSU countries including Russia, Indonesia, Bangladesh (major exporters of ammonia/urea to India) this is almost 100 per cent. Over there, gas is available at throw away price.

Energy consumption figures by plants in exporting countries is not readily available. The average for gas based plants in India (excluding Namrup which is sick) is about 26.0 m.Btu per tonne urea. However, for



comparison, let us take about 24 m.Btu — any plant designed to international standards should be capable of reaching this level — as benchmark to remove distorting affect of inefficiency in operation on either side.

For gas based plants in India located on-shore, energy cost per tonne urea will be 2.15 times and those of HBJ 3.10 times cost of plants in exporting countries getting gas at US $1.0 per m.Btu and several times more than plants in countries like Saudi Arabia, Oman, Qatar, where gas is priced even lower. At still higher prices in India, during 1999-2000, our energy cost will be more by factor of 2.8 and 3.7 respectively.

The naphtha and fuel oil based pants in India are even more unfavourably placed. The weighted average energy use by them (excluding sick plants) is about 32.0 m.Btu and about 35.0 m.Btu respectively. Between units, it varies depending on vintage, technology, state of plant and machinery etc. However, let us take standard norm of 28 m.Btu for naphtha based plants and 32 m.Btu for fuel oil.

Consequent to steep increase w.e.f. September 2, 1997, current ex-refinery prices are, naphtha Rs 7624 per tonne and fuel oil Rs 5508 per tonne. Although, delivered cost (factory gate) varies due to differential effect of freight and sales tax, on an average, it is about naphtha Rs 9000 per tonne and fuel oil Rs 7000 per tonne. In terms of $ per m.Btu, these are 6.0 and 4.8 respectively.

For producing a tonne of urea, the above will yield energy cost of US $168 for naphtha based plants and US $154 for plants on fuel oil. These are higher by a factor of 7.0 and 6.,4 than cost of plants in exporting countries paying gas price of US $1.0 per m.Btu and still more than in countries with cost lower than 1.0.

Indian industry has an inherent advantage to an extent urea coming from abroad incurs ocean freight and port handling charges, say about US $40 per tonne. So, we need to take a benchmark of US $64 which consists of this plus US $24 being energy cost in exporting countries paying gas price of US $1.0 per m.Btu.

On this basis, gas based on-shore units could be a shade better with energy cost of US $51.6 at existing gas price of US $2.15, but, worse off with US $67.2 at higher gas price of US $2.8 per m.Btu. Plants along HBJ would be worse off even at existing gas cost i.e. US $3.1 per m.Btu yielding energy cost of US $74.4, and much worse at higher gas cost of US $3.7 per m.Btu, yielding US $88.8.

For naphtha/fuel oil plants, energy cost i.e., US $168/154 is substantially higher than even US $64. Could the Indian producer do anything to offset this huge disadvantage? There are two ways of looking at it i.e, either, it reduces energy consumption nor saves on investment cost.

In the first, given naphtha/fuel oil cost in US $ per m.Btu of 6.0 and 4.8 respectively, energy consumption for producing a tonne urea should be at a level as to limit energy cost to only US $64. The required levels will be 10.6 m.Btu for naphtha based plants and 13.3 m.Btu for those on fuel oil. Such numbers are not only not capable for being achieved even under ideal conditions, but also, lie beyond the realm of possibility.

Taking excess of US $104 (168 - 64) and annual production of 0.768 million tonne, CRC of Indian plant will have to be lower by about US $80 million p.a. This corresponds to an investment of about US $400 million (taking capital servicing at 20 per cent). For this to happen, someone will have to virtually gift the pant in India if it has to complete with suppliers from abroad.

Within domestic industry also, naphtha/fuel oil plants are at a serious disadvantage. The energy cost of naphtha based plants is 3.26 times on-shore gas based units and 2.26 times that of HBJ plants. Likewise, cost of fuel oil based plants is 2.98/207 times on-shore/HBJ units. This may be offset, to an extent, by high CRC of newly set-up gas based units. However, vis-a-vis such plants set-up much earlier — mid/late 80s — and therefore, substantially depreciated, naptha /fuel oil plants would still be at a serious loss.

Notwithstanding handicap of Indian fertiliser industry vis-a-vis global suppliers and those of naphtha/fuel oil based plants vis-a-vis gas based plants at home, dismantling of RPS and allowing free imports will not only be unfair to producers, but also, imprudent from national angle. This would lead to large scale closure of plants, resultant loss of domestic production leading, in turn, to heavy dependence on imports and resultant exploitation in world market as in 70s.

Growth of capacity abroad — in countries where gas is cheap — to meet Indian demand may be an option. Perhaps, Indian industry may participate in this by way of JV as in Oman. But, on that, a strategic view has to be taken. Moreover, we need to ascertain whether such supplies including from JV would be at a reasonable price. The logistic angle especially woefully inadequate infrastructure at ports cannot also be ignored.

There is an urgent need to remove distortions in pricing of various feedstock and bring our energy cost at par with the cost in exporting countries. This may alone, it would be possible to promote healthy competition and ensure continued health and growth of the industry.