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Fertiliser expansion projects put on hold due to low selling price

By Uttam Gupta

THE Tata Chemicals Ltd (TCL) is reported to have put its proposed ammonia/urea expansion project at Babrala in cold storage. It is having problems in getting a reasonable price, under the RPS, for its existing unit earlier commissioned in December 1994. Fearing similar problems for the proposed venture, it is not in a mood to take risk. Others like Chambal, Oswal having initiated work on their expansion project at existing units i.e. Gadepan and Shahajahanpur respectively, are also placed in a similar dilemma.

Meanwhile, a high powered committee (HPC) under the chairmanship of Dr C. H. Hanumantha Rao has been set up to review the RPS and suggest changes. The HPC is not prevented from looking beyond the RPS. In fact, suggesting an alternative to the existing dispensation is one of the major terms of reference. This has added to the uncertainties and consequential wavering of interest.

Since mid 80s, cultivable land has stopped growing. Foodgrains production can be increased only by increasing productivity from every unit of land under plough. This, in turn, requires increasing supply of chemical fertilisers and nutrient balance sheet of the Indian soil is negative and organic sources cannot take on the load due to very small nutrient content (1—1.5 per cent). Imports on a large scale is not a dependable option. Hence, the paramount need for augmenting domestic production.

To realise this objective, a reasonably attractive return has to be assured to enthuse potential investors for setting up additional capacity and ensure that existing producers stay on and expand. This, in turn, would require that producers get a price which will covers reasonable cost of production including an attractive return.

What then, is coming in the way? Although, increasing fertiliser subsidy is made a scapegoat for lack of a conducive policy, none other than the Government itslef is responsible for it. Since, selling price of urea is controlled at a low level to encourage its use, excess of reasonable cost of production (C&F landed cost in case of imports) and distribution is reimbursed as subsidy. Subsidy payment therefore, depends on what you do to selling price and factors that determine production cost. This is where things have been messed up.

While, on the other hand, urea selling price has been kept at an artificially low level—no increase throughout 80s and very small increase in 90s—on the other, administered prices of naphtha, fuel oil, gas, power rates and railway freight have been steeply increased. For instance, the so called concessional price of naphtha to fertiliser units (ex-refinery) increased from Rs 1982 per tonne in 1990 to Rs 4840 per tonne w.e.f. July 3, 1996. After including excise duty (nil), freight and sales tax. Landed cost at factory point is about Rs 5800 per tonne. Taking 0.7 tonne of naphtha needed to produce one tonne urea, feedstock/fuel cost alone is Rs 4060 per tonne.

The ball does not stop here. The Ministry of Petroleum and Natural Gas (MPNG) is hell bent on withdrawing the concessional price sooner than later. Fertiliser plants will thus, be charged non-concessional price for naphtha which, at present, is Rs 6684 per tonne. With excise duty 10 per cent, freight and sales tax, cost at factory gate will be about Rs 9000 per tonne. This will push up feedstock/fuel cost to Rs 6300 per tonne. It will be even higher in the event of non-concessional rate itself being raised.

For gas based plants, present price at landfall point for off-shore gas and on-shore gas is Rs 1850 per 1000 cubic metre and for HBJ plants Rs 2700 per 1000 cubic metre. Including royalty 10 per cent, Central Sales Tax 4 per cent and sales tax though varying from State to State on an average about 5 per cent—the cost at factory point is about Rs 2300 per 1000 cubic metre for landfall/on-shore plants and Rs 3000 per 1000 cubic metre for HBJ plants.

Currently, only requirements of the main process plant are met from supply of gas whereas, for captive power and steam generation, units have to depend on alternate fuel such as naphtha. The break-up is about 5 million Kcal for former supplied through 600 cubic metre gas (1 cubic metre =8400 Kcal) and latter 1 million Kcal supplied from 0.1 feedstock/fuel cost per tonne urea for gas based plant on-shore is Rs 2280 (2300 ex 0.6 + 900 K 0.1) and Rs 2700 (43000 x 0.6 + 9000 ex 0.1) for HBJ plants.

In view of T. L. Shankar Committee recommendations, however, the price is likely to shoot up w.e.f 1.4.1997, price of off-shore gas at landfall point/onshore gas will be Rs 2050 per 1000 cubic metre and, along HBJ—pipeline, Rs 3200 per 1000 cubic metre. Thereafter, an increase of Rs 200 per 1000 cubic metre per annum successively for a period of 5 years has been proposed. At the end of 5 years period thus, former will be Rs 3050 per 1000 cubic metre and latter Rs 4200 per 1000 cubic metre.

At factory point, cost of gas will be to about Rs 3700 per 1000 cubic metre for land fall point/on-shore plants and Rs 4700 per 1000 cubic metre for plants along HBJ pipeline. At the enhanced rates, cost of feedstock/fuel per tonne urea will be Rs 3120 (3700 x 0.6 + 9000 x 0.1) for landfall/on-shore plants and Rs 3720 (4700 x 0.6 + 9000 x 0.1) for HBJ plants.

There is even a talk of charging all feedstock on a uniform basis under eventual deregulated regime for the hydrocarbon sector. Pricing of gas on naphtha equivalent—this suits oil and gas sector—would push up price to an exorbitant level of Rs 7500 per thousand cubic metre (9000 x 0.84). The corresponding feedstock/fuel cost, in that case, will be about Rs 5400 per tonne (7500 x 0.6 + 9000 x 0.1).

Feedstock/fuel is only one of the component of total cost of supplying urea. Other elements are capital servicing charges (CSC), conversion cost, bagging and distribution cost. These have to be suitably factored in to see, how farm gate cost would eventually look like vis-a-vis selling price."

Although, all existing naphtha based plants are old and fully depreciated, they need heavy investment on revamping and modernisation to sustain present level of production. While situation may vary from plant to plant, we may take a minimum of about Rs 2000 per tonne towards CSC. For a new grass root naphtha based project, at current prices, investment cost will be about Rs 1600 crore. This would entail CSC of about Rs 6400 per tonne.

The gas based projects—along HBJ pipeline—commissioned in the last couple of years (Chambal, Tata, Oswal) have investment in the range of Rs 1200 crore—1400 crore. For these, CSC works out to about Rs 4800-5600 per tonne. For remaining plants, along HBJ, set up in late 80s, (Indo-Gulf, Jagdishpur, IFFCO-Aonla, NFL-Bijapur) at almost half the cost, the CSC is about Rs 2000 per tonne. This will also hold for on-shore plants i.e. Kribhco, Hazzira and RCF-Thal as, despite still lower investment, due to earlier vintage 1985-86, they will require investment on revamping and update.

Add to CSC, relevant feed/fuel cost—as computed earlier—conversion cost about Rs 1000 per tonne bagging cost Rs 500 per tonne and Rs 500 per tonne towards distribution cost, we will get likely farmgate cost of supplying urea. This wuld be about Rs 10,300 per tonne from existing naphtha based units, Rs 14,700 per tonne from new grass root naphtha based project, Rs 10,500-11,300 per tonne for recent plants along HBJ, Rs 7700 per tonne for HBJ units of late 80s and Rs 7100 per tonne for landfall point/on-shore gas based plants of the mid 80s.

We are thus heading for a situation whereby reasonable cost of supplying indigenous urea to farmers will be about 1.94 times the existing selling price at bare minimum and 4 times at the maximum. The gap will be even higher if non-concessional price of naphtha is increased, or for gas pricing, naphtha equivalent route is adopted.

The Government is unwilling to tackle this unprecedented situation. Even small increase in selling price is not allowed as it apprehends baklash on farmers' vote bank. It sanctions steep increases in feedstock/fule prices as unilaterally decided by MPNG. Whether this is justified by increase in reasonable cost to refineries or not? This question is never raised. Ministry's rhetoric that supplies to fertiliser are heavily subsidised—no matter what the price level is—is enough to secure the NOD of the Cabinet.

What makes matters worse are attemtps to blame the industry for increasing subsidy. The Government does little to rebute these charges. Not only that, it makes adverse changes in pricing norms, delays payment of subsidy dues including escalation claims and even makes short payments under several heads. As a result, despite doing very well in physical terms, manufacturers do not get the return allowed under pricing.

This mind-set has to change. It must be clearly recognised that subsidy is not to the industry. It is only a conduit for facilitating sale of urea to farmers at a lower price. This is done to save on administrative costs which will be heavy if farmers are directly subsidised. The industry has no Allaudins' lamp either which could deal with subsidy monster—a creation of uncoordinated and arbitrary actions of various wings in the Government.

No doubt, the industry has to be accountable for efficiency in operations. This should not however, be pushed to the point of discouraging efforts to do better. For dealing with subsidy, the contributory factors should be brought under focus. Increase in selling price is the natural choice. We should aim at about Rs 8000 per tonne from existing Rs 3660 per tonne over a 5 year time frame. This would require an increase of 20 per annum in first two years and 15 per cent per annum in subsequent three years.

Increase in price will solve only part of the problem, as even at Rs 3000 per tonne, realisation would be substantially short of cost of majority of plants. As a second major step feedstock/fuel cost have to be kept under check. The JPC had recommended, in August 1992, reduction in price of gas by 35 per cent removal of royalty, reduction in charge for transporting gas along HBJ and freezing prices of feedstock other than gas at existing levels. Even before the ink was dry, feedstock prices were raised in September 1992 and thereafer, another steep hike in July 1996. Gas price too has been raised steeply since 1992.

The prices of all hydrocarbon feedstock should be frozen at existing level. This would help in containing cost and bring majority of plants in the viability zone. However, new units will need one time capital subsidy to offset inherent handicap of coming late. Other alternatives like substitution of high cost loans from domestic FIs/Banks by foreign currency loans—the latter bear less than half interest rate—could also be tried.

With these pre-conditions in place, we could perhaps, think of removing control on urea and subsidy regime at the end of five year period. Till then, however, the RPS has to continue to facilitate smooth transition and enable industry and farmers adjust to the decontrolled regime without any adverse effect on production and consumption.