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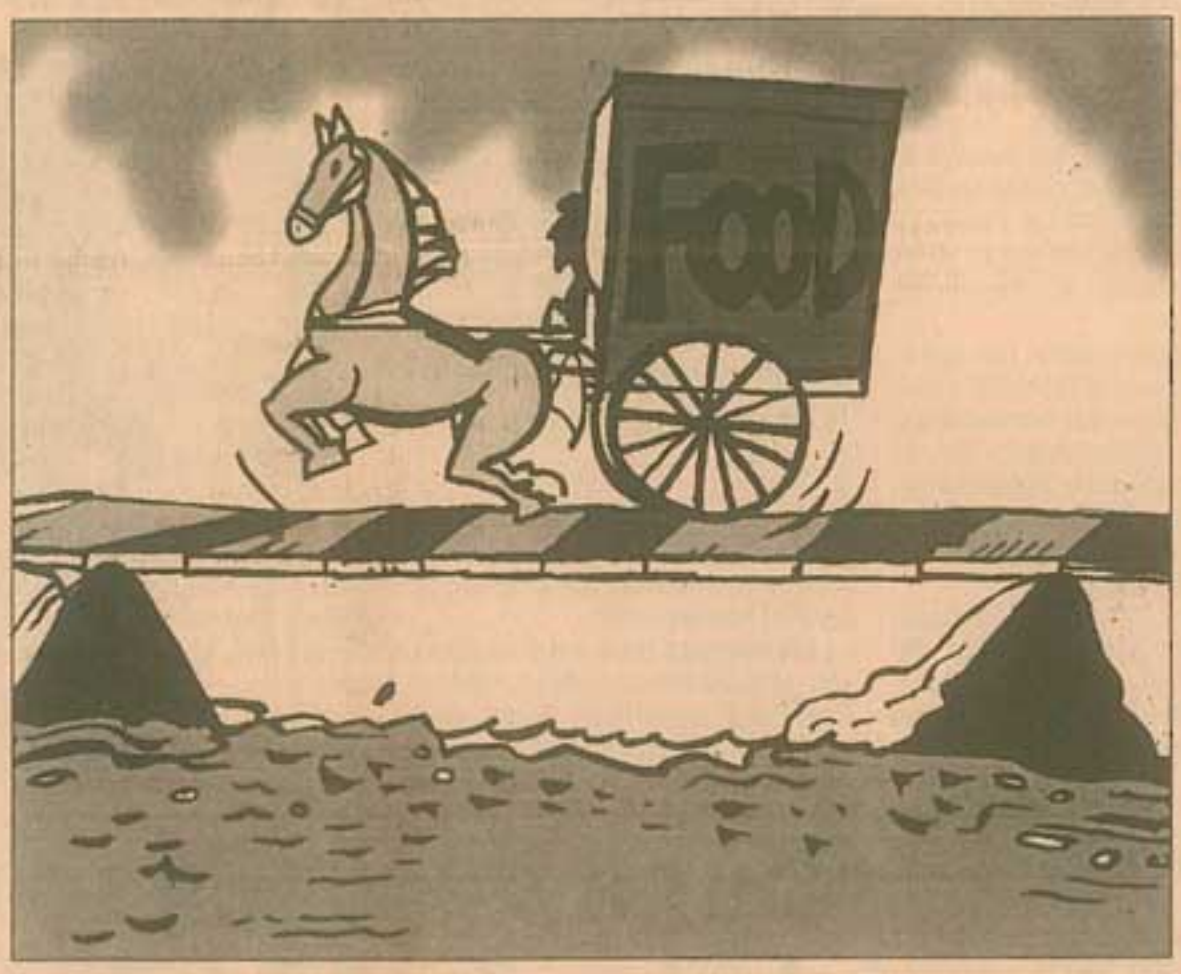
Food security & fertiliser industry

Given the role fertilisers play in food production, the speical price of feedstock on supplies to the industry should continue, argues **Uttam Gupta**



Apart from being a source of energy, naphtha has chemical value which is best used in the production of fertilisers. The latter being an essential input in agriculture and in view of the overriding objective to achieve self-sufficiency in foodgrains production, in the '60s and '70s, bulk of the naphtha supplies from the refineries were made to fertiliser plants. At the end of '70s, about 50 per cent of the nitrogen production capacity in the country was based on naphtha.

Thereafter, following discovery of natural gas in the Bombay High and South Bassein region and its increasing availability, the additional nitrogen capacity in the '80s and early '90s, was based on gas as this is distinctly superior to naphtha in terms of energy efficiency apart from entailing lower investment cost.

Of late, with no gas being made available to any new project including expansion at existing site and even the existing gas based units being denied their requirements in full, naphtha has once again become a very important raw material.

In the early '70s, the government took a conscious policy decision to supply naphtha to the fertiliser plants at a price lower than for other industrial uses. In the late '70s, as some plants were set up on other liquid hydrocarbons i.e., fuel oil, LSHS, etc., this principle was extended to cover these supplies as well.

As on March 1990, the ex-refinery price of naphtha to fertiliser units was Rs 1982 per tonne as against Rs 3211 per tonne for non-fertiliser use. In the '90s, prior to July 1996, the price for both the categories was raised uniformly, i.e., 25 per cent in October 1990, 10 per cent in July 1991 and 36 per cent in September 1992. As a result of these increases, the special price for fertilisers was Rs 3723 per tonne as against Rs 6076 for non-fertiliser use. With effect from July 3, 1996, however, while the price for non-fertiliser use was increased by only 10 per cent to Rs 6683 per tonne, for fertilisers, the hike was substantially higher by 30 per cent to Rs 4840 per tonne. Under the contemplated restructuring plan for the hydrocarbon sector, the government intends to completely do away with the concessional price for fertilisers.

While, the D-day may come sooner than later, already, supplies for running steam generation and captive power plants in fertiliser units are being charged at non-concessional rates. A distinction is also sought to be made between the use of naphtha as feed and fuel (normally in the ratio of 2/3 and 1/3) for charging supplies for the latter at the non-concessional rate. Moreover, for new projects including expansion at existing sites, the ministry of petroleum has decided not to make domestic naphtha available at the concessional price.

It is but inevitable that the production cost of food will rise steeply if the fertiliser cost increases due to increase in feedstock cost. In the '90s, for a typical naphtha based plant using fuel oil for off-site facilities, the cost of producing urea increased by about Rs 2500 per tonne purely on account of the increase in the concessional price of naphtha/fueloil. Against this, the increase in selling price of urea has been only Rs 970 per tonne. The increasing gap has been met by corresponding increase in the quantum of fertiliser subsidy.

The government could, perhaps, raise subsidy further to absorb the effect of increase in feedstock cost consequent to charging non-concessional rate and thus, prevent increase in the cost of food. To get an idea of how much increase would be needed, let us consider some basic facts.

At the prevailing factory gate cost (ex-refinery price + excise duty + transport + freight) of naphtha and fuel oil at about Rs 5500 per tonne and Rs 4800 per tonne respectively, their contribution alone to the cost of producing urea is about Rs 4200 per tonne. At costs corresponding to the non-concessional rates, i.e., naphtha about Rs 8500 per tonne and fuel oil about Rs 7300 per tonne, this will increase to about Rs 6600 per tonne. Under the retention pricing scheme (RPS), the increase in the cost by Rs 2400 per tonne (6600 - 4200) has to be allowed as additional subsidy.

In the event of urea decontrol, the selling price to the farmers will increase by about 85 per cent if the concessional price on feedstock continues and about 120 per cent if the industry has to pay the non-concessional price. This is bound to lead to steep decline in its consumption as happened to P and K fertilisers following their sudden decontrol. In turn, this would cause steep fall in foodgrains production.

There is total lack of coordination in dealing with the issues that are inter-liked. This is because the concerned ministries, i.e. MPNG, MOA and MOF, are over-zealously pursuing the interest of their respective constituencies in isolation. This has resulted in slow growth in fertiliser use, increasing imbalance and decline in foodgrains production. And yet, the deficit in the OPA is ballooning, fertiliser subsidy continues to rise and farmers are paying high prices specially for P&K fertilisers.

The government should frame a coordinated and pragmatic policy covering all the three sectors i.e. feedstock, fertilisers and food. Given the strategic importance of food and the vital role of fertiliser in it, the special price of feedstock on supplies to the fertiliser industry should continue.

Even so, the OPA was expected to be self-sustaining with higher prices on items like petrol, ATF, and feedstock/fuel for non-fertiliser use, etc., cross-subsidising lower prices on products catering to the weaker sections. The arrangement worked well until the end '80s and would have run well in the '90s too but for the gross mismanagement in recent years.

In the '90s, except kerosene, even the so-called concessional rates have been increased sharply. For instance, the price of naphtha to fertiliser industry now is about 145 per cent more than in 1990. Despite this, if there is deficit in the OPA, the problem is internal to it.

The concessional rate has to be scrutinised. On what basis, is it surmised that Rs 4840 per tonne charged to fertiliser is a subsidised price? Subsidy arises only if the reasonable production cost is higher than the selling price. Information on the former is a guarded secret. The entire exercise is non-transparent and lacks accountability.

Even if it turns out that the reasonable cost is higher, it would still be desirable to charge the lower price rather than subsidising the fertiliser industry directly (as suggested by the oil industry). This is because every rupee increase in the price of naphtha raises the cost of producing urea by more than a rupee due to increase in excise duty and local taxes levied on percentage basis and the cost of working capital. The additional cost can be prevented if subsidy is given at the input stage.

Ideally, the feedstock prices should be rolled back to the 1992 level as the JPC recommended. However, at the least these should be set at the pre-July 1996 level. The supplies for off-site facilities in fertiliser plants should also be charged on the same basis. The government should, at the same time, increase urea selling price in steps of, say, 15-20 per cent per annum to bring it closer to the reasonable cost of supply without affecting fertiliser use and in turn, foodgrains production. This will also contribute to saving in subsidy i.e. about Rs 900-1200 crore per annum.

Considering that the benefit of increasing foodgrains production and keeping the cost of food low accrues to every section of the society, the attendant cost in enabling this must also be shared equitably. The pricing of feedstock, fertilisers and food has to fit suitably into this broad objective. Any imbalance leading to too much burden on any one sector will have catastrophic consequences.

(The author is chief economist, The Fertiliser Association of India, New Delhi)