

# Mechanics behind urea subsidy and its payment

Dr Uttam Gupta

**R**ECENTLY, a member of Parliamentary Standing Committee on Petroleum and Chemicals, is reported to have alleged that some urea manufacturers have been paid an excess of about Rs 1,000 crores towards subsidy. The Government has not contradicted this; instead, there are reports that DOF is scrutinising units reporting high capacity utilisation with a view to pinpoint such cases, if any.

Why does excess payment arise? What is the basis of the allegation? To get a cue, let us take a brief look at the mechanism for determining subsidy and making payment.

The selling price of urea is controlled at a low level — unrelated to production cost — to induce increase in its consumption and in turn, enable increase, in food-grains production. Concurrently, GOI runs retention pricing scheme (RPS) under which, it fixes unit-specific fair ex-factory price — commonly known as retention price (RP) — based on prescribed efficiency norms. The excess of this over net back from sale (selling price minus distribution margin) is reimbursed as subsidy.

A major component of RP is fixed cost including capital related charges (CRC). For arriving at CRC, allowable charges viz, depreciation @6.33 per cent, return 12 per cent post-tax on net-worth (shareholders' funds) — this is grossed up by prevailing rate of corporate tax — and interest on loans say, Rs 'y' in crores are divided by normative production level.

The normative production level is computed by applying prescribed percentage to the base/installed capacity of the plant. For a gas based plant, this is 90 per cent from 2nd to 10th year after start of commercial production and 85 per cent from 11th year onwards. For naphtha/fuel oil based plant, this is 85 per cent from 2nd to 10th year and 80 per cent from 11th year onwards.

With this at the backdrop, crux of the allegation is that whereas plant has capacity of  $x+dx$  tonnes, company declares only 'x'. Thus, even though, unit should have got

CRC of  $y/x+dx$ , actually, it gets  $y/x$  resulting in an unintended gain in the ratio of  $dx/x+dx$ . So, every thing hinges on existence of  $dx$ . The critics often look at capacity utilisation above 100 per cent to conclude that  $dx$  does exist. Herein, we need to look at a few intricate facts to facilitate a balanced view.

All plants along HRB pipeline have an installed capacity of 7.26 lakh tonnes per annum. This is based on 2200 tonnes per day (tpd) multiplied by 330 days; balance 35 days in a year are excluded to allow for plant shut-down for routine maintenance. The figure of 2200 tpd, in turn, is obtained by dividing ammonia plant capacity i.e., 1350 tpd by 0.613 (tonne of ammonia needed to produce a tonne of urea).

For the purpose of pricing, however base capacity is taken as 7.68 lakh tonnes per annum. To arrive at this, ammonia capacity i.e., 1350 tpd divided by 0.58 (instead of 0.613) to yield 2327 tpd. Multiplied by 330, this would give 7.68 lakh tonnes per annum. The difference of 0.42 lakh tonnes (7.68 — 7.26) should, therefore, not be confused with excess capacity. It is an aberration only on paper.

To see whether a plant operates above 100 per cent, actual production should be seen in relation to 7.68 lakh tonnes. Herein, two basic points need to be kept in view. First, through better planning, management and maintenance practices, a unit can skip routine annual shutdown which gives 35 extra stream days of production or about 10 per cent.

Second, invariably, plants are designed to run at the optimum load even during adverse conditions viz, high temperature, supply of lean gas and aging of catalyst etc. This is a standard international practice. Thus, when, conditions are favourable, a unit which can exploit these would get a further 10 per cent. Overall, a plant can achieve production upto 12 per cent of base capacity or 9.216 lakh tonnes (7.68 x 1.2). This is technically feasible.

It is not clear as to how alleged figure of Rs 1,000 crores has been arrived at. However, reckon extra realisation towards CRC on difference between 9.216 and 7.68 i.e., 1.536 lakh tonnes as unintended

bonanza would be totally illogical and unjustified. In all fairness, this should be treated as an incentive for doing better.

Viewing this better performance with suspicion is bad enough. What is even worse is contemplated move by DOF to re-fix base capacity at best production level achieved by the unit. This would mean that CRC would be re-computed using 90 per cent of 9.216 lakh tonnes i.e., 8.294 lakh tonnes up from 6.912 lakh tonnes (90 per cent of 7.68).

Apart from taking away incentive to do better, in a situation when, due to adverse operating conditions, the unit cannot even reach 8.294 lakh tonnes, it would lose, heavily. This is even contrary to the basic tenet of normative pricing i.e., the system should reward improvement in efficiency and penalise inefficiency.

The units face huge under-recoveries under various cost heads viz., repairs and maintenance, rembursement for various taxes and duties, impact of exchange rate fluctuations etc. Faced with these and if they had operated only at normative production levels they would not have even earned 12 cent or even made losses. By increasing capacity utilisation, they have managed to sail through.

Under-recoveries being a more or less permanent feature, we need to take a holistic view and not simply get obsessed with the gain due to higher production. After all, in the ultimate analysis, what matters is the money that a unit earns and it would be improper to ignore under-recoveries which is often, the case.

Ironically, even old vintage plants have been unnecessarily dragged into the cloud of suspicion. Majorit of these plants were commissioned or in advanced stage of implementation before RPS was introduced in November 1977. How could they have built-in excess capacity in anticipation that such a scheme would be introduced later?

For several years after commissioning, they operated at low utilisation. Even after RPS, it took them many years to reach optimum levels. While, this has been the result of proper upkeep, timely replacement of equipment and improved maintenance/management

etc, it will not only be illogical, but also, unethical to see something hanky panky in their working. And, all this when they are unable to generate funds so badly needed for revamp and modernisation.

We need to take an objective and dispassionate view of the whole situation. If, the impression that RPS allows producers to make a fast buck — say, by alleged gold plating — was correct, then, investors including foreign investors, would have made a bee-line for it. But, you have a lot of disappointment there. There is hardly any interest by private parties and not even a single case of foreign investment.

Even for the sake of argument, assuming that units have been merrily enjoying the benefit of hidden capacity, then, more than anything else, Government needs to do an introspection about its own role. The plants under suspicion were conceived, planned and implemented under a controlled regime. At every stage, they were under scrutiny by Government and its agencies viz, financial institutions/banks etc. How come then, cases of excess capacity, if any, were not detected?

Even now, all that one hears is that relevant cases are under scrutiny/examination. Already, much propaganda hype over this issue has led to continuing uncertainties of the policy. This is causing much more damage than the loss of a few hundred crores of rupees by way of alleged excess payments to the concerned corporates.

The need of the hour is to ensure that continuing uncertainty over the issue does not stay for a day more. The current thrust on witch-hunting should give way to a realistic/pragmatic approach. The cases of unusually high capacity utilisation may be tackled by putting a cap/ceiling beyond which all units should get a uniform CRC say, Rs 1000/1500 per tonne.

This being substantially lower than CRC to these units (allowed on production up to ceiling), while, on the one hand, there will be in-built punishment, on the other, Government will also save on subsidy. Moreover, country will get incremental production at cost significantly lower than cost of imports even at current dumping price.