THE ECONOMIC TIMES

30 NOVEMBER 2000 VOLUME 40 NO 233

Guest Column

UTTAM GUPTA

Mirage of a saving

Recently, the Expenditure Reforms Commission (ERC) has recommended adoption of uniform concession based on weighted average retention price (RP) for five groups of plants, i.e., pre-1992 gas based, post-1992 gas based; naphtha based plants, fuel oil based plants and plants based on mixed feed. Having condemned retention pricing scheme (RPS), it is perplexing to find the commission using it as a building block for its own package.

If the former suffers from deficiencies, how can the latter remain free from these?

The ERC's mandate was to suggest ways and means to reduce subsidy. By merely taking weighted average of RP under each group, there is no saving in subsidy. This only results in re-distribution of money leading to inter-unit distortions. Whereas some units make gains, others incur unwarranted losses.

But, ERC has shown substantial savings of about Rs 2000 crore! This is largely the result of using "assumed" import parity price (IMPP) in computation of energy cost for plants in naphtha, fuel oil/LSHS and mixed feed groups. The implicit assumption that units are free to import is not valid as in case of naphtha, this is not permitted under EXIM policy.

Assumed numbers are also highly unrealistic. For instance, in fuel oil/LSHS group, recommended reduction in concession is about Rs 3200 per tonne urea. On per tonne LSHS basis, this works out to Rs 7455.

Current cost of LSHS being about Rs 9345 per tonne (to a plant in Gujarat), cut will necessitate its purchase at Rs 1890 per tonne or an FOB Arab Gulf price of US $0.025 per tonne; an impossible number to say the least!

In Stage-2, i.e., from 1 April 2002 to 31 March 2005, ERC expects plants on naphtha, fuel oil/LSHS and mixed feed to operate at significantly lower energy consumption levels. Likewise, in Stage-3, i.e., from 1 April 2005 to 31 March 2006, it expects all plants other than gas to switch-over to the use of LNG. Accordingly, concession rates are reduced yielding corresponding savings in subsidy.

These expectations are highly unrealistic. To achieve energy consumption targets, plants need to invest heavily in revamp/modernisation. Where is the money for this when, already in Stage-1, they have been cut to size? Even the time allowed, i.e., 14 months (1 February 2001 to 31 March 2002) is less. In regard to the use of LNG, apart from problem of funds needed for switch-over, one is not sure whether LNG will be on tap at plant site by 1 April 2005!

ERC has recommended an increase in the selling price of urea @ 7 per cent per annum from April 2001. On current base of Rs 4600 per tonne, this would reach Rs 6900 per tonne as on 1 April 2006. At this point or Stage-4, concession for all plants except those on LNG, is proposed to be reduced to nil. For the latter, FDCR (feedstock differential cost reimbursement) of Rs 1900 per tonne is mooted.

The above presupposes that price of domestic gas will be maintained at existing level, i.e., about US $2.5 per million Btu (to plants along HBJ). This is erroneous as with the impending removal of cap on basic price and linkage to 100 per cent parity with IMPP of a basket of internationally traded fuel oils, this will almost double at the beginning of 2001-02 itself.

In a nutshell thus, savings achieved by ERC are largely the result of using highly theoretical numbers in various computations. In its obsession to add to the "savings kitty", it has even resorted to some ingenious ways. For instance, a peculiar technique of rounding weighted average RP, i.e., treating last two digits as '00', yields savings of about Rs 100 crore.

In another proposal, whenever, IMPP of feedstock goes down, concession will be reduced. But, when the former goes up, ERC has recommended an increase in the selling price.

This way, it will ensure that on account of variations in feedstock cost, subsidy can only decrease. But, at the cost of crippling industry as it won't be easy to pass on cost increase to farmers.

To conclude, ERC recognises that apart from increasing the selling price albeit in small doses, subsidy can be reduced by drastically reducing cost of feedstock. However, it is totally wrong in assuming that this can be achieved merely by setting a highly theoretical target (for instance, LSHS price of US $0.025 per tonne FOB) and fixing concession on that basis.

(The author is chief economist, the Fertiliser Association of India. These are his personal views and not that of the organisation)