

# RPS-unjustifiably blamed for high cost indigenous fertilisers

By Uttam Gupta

**T**IME and again, the fertiliser industry in India has come under attack because of the high cost at which it produces urea. The critiques also say that this is mainly due to inefficiencies in production which are supported by the retention pricing and subsidy scheme (RPS) in vogue since 1977. And, if, RPS is dismantled and free imports allowed, the manufacturers will be forced to cut costs.

In an absolute sense, high cost has no meaning. To be meaningful, it has to be seen in relation to either the price paid by farmers or cost of supplying urea through imports. Currently, the reasonable cost of production and distribution from plants in India on a weighted average basis is about Rs 7,500 per tonne. This is more than double the selling price of Rs 3,660 per tonne and about 1.25 times the current farmgate cost of imported urea of about Rs 6,000 per tonne (corresponding to C&F cost of US \$ 20 per tonne).

No doubt, production cost from our plants are high, but this is not due to alleged inefficiency of the industry. What is the factual position? During 1996-97, the average capacity utilisation was 93.2 per cent in nitrogen and 87.5 per cent in phosphate. Excluding sick plants, capacity utilisation in 'N' was even higher (sick plants belonging to FCI/HFC do not produce 'P' fertilisers).

For gas based plants in India, the average energy consumption per tonne ammonia during 1995-96 was 9.16 million Kcal. Excluding Namrup, which is a sick unit, the average was even lower at 8.97 million Kcal. As against this, the energy consumption for gas based plants in the USA during 1995 was 9.93 million Kcal according to a TFI production cost survey, results of which were presented in the 1996 IFA technical conference. In terms of efficiency, thus, the Indian industry is comparable to the best in the world.

Far from protecting inefficiency, the RPS forces the manufacturers to be more and more efficient. This is because under it, fair ex-factory, price — commonly known as retention price (RP) is fixed on the basis of prescribed efficiency norms in regard to capacity utilisation and

consumption of raw materials (including feedstock) and utilities. For instance, for a gas based plant, fixed cost including capital related charges (CRC) are allowed at 90 per cent utilisation of the installed capacity.

A unit which operates below this say, 80 per cent, recovers only 8/9 of its fixed cost and hence, penalised. In contrast, a unit which does better say 100 per cent, gets higher recovery by a factor of 10/9. That the FCI and HFC group of plants make huge losses is mainly because their higher cost of production due to operational inefficiencies — caused by design/equipment problems, etc. — is not protected under the RPS.

Unfortunately, majority of the units working at efficiency levels better than the norm have been penalised due to progressive tightening of the norms over the years, e.g., increase in capacity utilisation norm for gas based plants from 80 per cent to 90 per cent w.e.f. 1.4.1988 — and underrecovery/inadequate compensation for various costs reasonably and necessarily incurred. This has seriously affected profitability despite high efficiency. In the emerging scenario, not only no prospective investor, including foreign companies, wishes to invest in fertilisers, even the existing units are diversifying into other areas.

Despite high efficiency, if the cost of production from plants in India is high, this is primarily because of ever increasing cost of feedstock/fuel, utilities, e.g., power and water, services, e.g., railway freight, etc., and increasing burden of taxes and duties. For instance, the price of naphtha (ex-refinery) increased from about Rs 596 per tonne in 1980 to the current level of Rs 7,624 per tonne, i.e., an increase of Rs 7,028 per tonne. This alone would have raised cost of production from a naphtha based plant by a whopping about Rs 4,920 per tonne (taking 0.7 tonne naphtha needed to produce a tonne urea).

In sharp contrast, the selling price of urea — controlled by the Government — remained unchanged all through the decade of 1980s at Rs 2,350 per tonne and even in the 90s, increased at snails pace to the current level of Rs 3,660 per tonne, i.e. an increase of only Rs 1,310 per tonne. The farmer has thus, been

made to pay only 1/4th of the increase in cost of production caused by increase in the ex-refinery price of naphtha alone.

Corresponding to the basic price of Rs 7,624 per tonne (ex-refinery) and after including freight and cascading effect of sales tax (being as high as 20 per cent in states like Gujarat), delivered cost at the factory gate works out to about Rs 9,500 per tonne or Rs 950 per m. Kcal. Thus, despite fairly high efficiency level, i.e. 7 m. Kcal. for a tonne urea, the feedstock cost alone would be about Rs 6,650 per tonne. It should, therefore, be no surprise that almost all naphtha based plants have RP of Rs 8,000 per tonne plts.

The gas based plants are somewhat better placed. The delivered cost of gas at factory tap is about Rs 300 per million Kcal to plants at landfall point/using onshore gas and about Rs 430 per million Kcal to plants along HBJ. Due to short supply of gas, they are, however, required to use alternate fuel, i.e. naphtha. Generally, the gas to naphtha ratio in total energy requirement is about 75:25. Thus, the effective cost of energy would be about Rs 450 per million Kcal to plants at landfall/onshore and Rs 550 per million Kcal to plants along HBJ pipeline.

Taking 6 million Kcal needed to produce one tonne of urea, for a gas based plant thus the energy cost would be about Rs 2,700 per tonne for plants located at landfall point and Rs 3,300 per tonne for plants along HBJ. But then, many of these plants are newly commissioned and are burdened with high CRC leading to production cost comparable to old depreciated naphtha based plants.

How does the production cost of the Indian industry compare with the cost in exporting countries say, the Middle East? Clearly, our cost is much higher. This is because as against the delivered cost of energy of US \$6.00 per million Btu to naphtha based plants, US \$ 3.0 per million Btu to gas based units at landfall point and US \$ 3.7 per million Btu to plants along HBJ, feedstock in the Middle East — almost entirely as natural gas — is available at throwaway price of upto US \$ 1.0 per million Btu; to the proposed joint venture in Oman, this is about US \$ 0.77 per

million Btu. However, the benefit of this is not available to India as purchases from world market (including supplies from JV) are at the prevailing international prices which are based on global demand-supply balance.

The farmgate cost of imported urea corresponding to prevailing C&F cost of US \$ 120 per tonne is about Rs 6,000 per tonne as against weighted average cost of indigenous urea at about Rs 7,500 per tonne. But, you cannot take a short-term view. Over a reasonably long period i.e. 1991-92 to 1996-97, excepting 1993-94, in all other years, farmgate cost of imported urea was significantly higher than that of indigenous urea. During 1993-94, former was lower mainly due to global surplus caused by dumping of material by Russia and CIS countries which, in turn, was the result of steep decline in their internal consumption due to removal of subsidies and resultant higher prices.

The present low C&F cost of imported urea is primarily due to China remaining away from the international market so far, during the current year. With China reentering the market sooner than later, the prices would increase leading to imported urea becoming costlier than the indigenous. In fact, only two years ago, i.e. 1995-96, when world demand-supply balance was tight, the C&F cost was a high of about US \$ 245 per tonne. A repeat of this situation is not ruled out specially if India steps up imports significantly by neglecting domestic production.

The Indian fertiliser industry is already world class with efficiency levels comparable to the best. Let us not confuse high production cost with the so-called inefficiency. The high cost is largely beyond industry's control and is, in fact, controlled by the Government. If, the critics are really concerned about it, then, they would do well to train their guns on the policy in regard to the pricing of feedstock, other inputs, taxes and duties and high interest rates rather than unjustifiably laying the blame on the doorsteps of the RPS and the industry.

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