

Rejuvenate the old

It makes sense to support vintage plants than setting up new fertiliser units at high cost, argues Uttam Gupta

LIKE IN bringing up a child, a project too needs investment for years before it gives returns. Even after meeting the variable cost (VC) and other expenses, a plant, for at least 8 years (period of loan repayment) after commissioning, entails a heavy burden of servicing the capital i.e. interest, depreciation. Thereafter, once the loans are fully paid and the plant is more or less fully depreciated, it generates handsome surplus.

This indeed is the period — akin to a grown up child — when the plant yields riches for its shareholders, including promoters, as well as the government which then gets the corporate tax in full. Such surpluses come handy in funding the revamp and modernisation of the plant when it turns old, as well as for supporting future growth i.e. contributing to equity capital of new grassroot plants.

In a free market, vintage plants have an edge over newly-commissioned units which reel under the burden of heavy capital related charge (CRC). Though, the latter may have the benefits of latest technology and economies of scale which give them an edge in raw material/energy use efficiency and possible lower fixed cost, these are more than offset by inflation/rupee depreciation-led higher investment cost.

In the fertiliser sector, of 34 urea manufacturing units, 16 with production of 5.44 million tonne (1996-97), are more than 20 years old — set up prior to 1975-76. Those were the days of low inflation, investment and energy cost, and consequently, low production cost. For all plants, production cost was even lower than the realisation from selling at low, controlled prices.

When the cost of imported urea zoomed to about \$270 per tonne after the oil crisis in 1974-75, leading to a farmgate cost of about Rs 3000 per tonne, the selling price was nearly doubled to Rs 2,000 per tonne. Despite this, imported urea was heavily subsidised.

The money for this came from a cess — known as fertiliser pool equalisation charge (FPEC) — imposed on domestic producers, whose cost was much lower than Rs 2,000 per tonne.

The price hike pushed down nitrogen consumption by about 3.5 per cent during 1974-75. So the price was reduced to Rs 1,850 per tonne in 1975-76. Thereafter, price reduction continued at Rs 100 per tonne per annum to reach a low of Rs 1,450 per tonne by 1979-80. Keeping in view the lower prices and the increasing cost, FPEC was withdrawn in June 1980.

The Retention Pricing and Subsidy Scheme (RPS) was introduced in November 1977 to protect the viability of projects under implementation e.g. MCF and SPIC, and attract fresh investment. Under RPS, a unit is given a fair price to cover its reasonable production cost at prescribed norms of capacity efficiency and consumption of feed-



duction cost — for a fully depreciated, low networth vintage plant is bound to be lower than a new unit with higher investment cost. The CRC applicable is built into the retention price (RP) which is lower for the vintage plant. While a part of RP is ex-factory realisation from sales to farmers at controlled price — this is uniform for all plants — the rest comes as differential subsidy from GOI.

In short, the system provides for payment to a unit on the basis of cost incurred — subject to efficiency norms — and not on the principle of available opportunities. In fact, due to the control on selling price, the latter becomes redundant.

But for this, in the absence of RPS, a vintage plant would have got a realisation — linked to market determined price — significantly higher than what it gets under RPS. A new unit, on the contrary, would realise a significantly lower amount.

Caught between the need to continue RPS for inducing higher consumption and protecting the viability of new units to ensure capacity growth, vintage plants were denied the opportunity of having better price realisation. This, in turn, constrained their ability to generate surpluses.

The existing dispensation allows full recovery of fixed cost, including CRC, at nor-

ability. Indeed, vintage plants have raised capacity utilisation; some of them operating at 100 per cent and above. However, since the CRC per tonne being low, these extra efforts have not generated adequate resources. Still, moves are afoot to disallow CRC above a certain capacity utilisation.

As for savings in VC, improvements in the operational efficiency of many plants have been eaten away by the successive reduction in RP. This has been adversely commented upon even by the JPC. The units have also been affected from under-recoveries in various heads such as repairs and maintenance (R&M), depreciation on capital addition, thus eroding profitability.

Even as some plants now manage to operate at high capacity through routine capital additions and R&M, there's fear how long they can sustain production at optimum levels. To ensure their continued running at optimum capacity, timely revamp, debottlenecking and modernisation of plant and equipment are needed. This is not possible with the meagre internal resources generated under RPS.

Unless timely incentives are provided, many efficiently-run vintage plants may join the ranks of sick units in the public sector.

The country cannot afford to lose pro-

or imports will be much more costly. As per the latest notified RPs, subsidy for old vintage plants, on a weighted average basis, works out to about Rs 2,700 per tonne against a minimum Rs 4,000 per tonne to a new unit.

The subsidy on imported urea even at the currently depressed C&F landed cost of \$130 per tonne (mainly from China keeping off the world market) is about Rs 2,750 per tonne. A few months back, C&F cost was \$165 per tonne, with a subsidy component of Rs 4,000 per tonne. About a year ago, subsidy was at Rs 6,500 per tonne.

What then could be the measures to retrieve the situation? Now the capacity utilisation norm for naphtha-based plants — these are mostly old units — is 85 per cent for production during the 2nd to 10th year, and 80 per cent from the 11th year onwards. For plants of more than 20 years vintage, a still lower norm of 70 per cent would enhance RP and thus help improve their bottomline.

As a further measure, these plants should be given a minimum return on networth (NW). In his context, in the the second pricing period — 1-4-1979 to 31-3-1982 — return on subscribed equity capital for loss making units — whereby the entire capital base had been eroded — was allowed.

The objective was to enable these units to earn a reasonable return and give them a chance to make cash profits via improved capacity utilisation/efficiency.

The need to give vintage plants a minimum return on networth should be seen in the context of preventing their slide into sickness inasmuch the same way as a minimum return on the subscribed capital of loss making units was considered necessary for rehabilitating them.

The extra money given to them in this manner will be more than offset by the huge saving in subsidy that would accrue by avoiding imports or setting up fresh capacity at high cost.

Thanks to inadequate budget provisioning and the subsequent shortfall in fund availability, normally, there is delay in the release of payments.

In view of this, and considering that liquidity of old plants is heavily dependent on government subsidy, vintage plants may be given priority in the release of payments, particularly, towards various escalation claims — increase in the cost of inputs/utilities/services — on the same lines as for loss making units.

Finally, the government should not implement the ministry of petroleum and natural gas' proposal to charge feedstock supplies at non-concessional rates, as this would lead to a steep increase in the cost of production i.e. at least by Rs 2,000 per tonne for naphtha-based units. Under RPS this would lead to problems in timely payments of subsidy dues and in the eventual