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Resurrecting Indo-Oman urea project

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The fate of the much talked about Oman project became uncertain last year when the French Export Credit Agency decided to withdraw from financing it. The argument given by the agency was that at the prevailing low international price of urea (under the agreement, entire production was to be bought back by Indian partners viz., RCF/KRIBHCO at this price), the project would not be viable. This is seriously flawed.

The argument presupposes that the international price of urea will continue to stay at the existing depressed level, i.e., US $65-85 per tonne FOB (1998/1999) throughout the life of the project. This is a baseless assumption as the price is prone to wide fluctuations depending on the prevailing global demand supply balance in which imports by India and China play a dominant role.

During the '90s, barring 1993/ 94 when, price tumbled following Russia and other FSU countries dumping their export surplus (caused by drastic reduction in domestic consumption following sudden withdrawal of subsidies) and again during 1990/99 when there was ban on urea imports by China besides India substantially reducing its imports, it remained high. The price was generally higher than the bench mark level of US $110 per tonne at which reasonable production cost from project would be fully covered.

The trends in future will be broadly similar. In fact, consequent to projected significant decline in global urea surplus from 3.597 million tonnes N in 1999 to 2.114 million tonnes N during 2003 (IFA, 1999) price is expected to increase sharply. Following entry of China into WTO and resultant freeing of imports a large portion of its high cost domestic capacity is likely to be wiped out. This would lead to further tightening of global situation and in turn, higher process.

In view of above, international price of urea is likely to be significantly higher than reasonable production cost from the project for a fairly large part of its life. Recently, efforts have been made to reduce project cost from US $1.1 billion earlier to about US $950 million. Consequential reduction in production cost will further improve profit margins. After 6-7 years from start of commercial production, when, capital related charges (CRC) will reduce sharply, the picture will be rosy.

In short, the terms of buy-back agreement were so designed as to guarantee a fairly attractive return on the project. In fact, it was loaded against India — as a buyer — in as much as whenever, international price goes below bench mark price, RCF/KRIBHCO would extend a soft loan equal to the differential; a typical case of heads I win and tails you loose for the Omanese.

It would now appear that terms of agreement are being re-worked to provide for buy-back of urea at a constant price linked to reasonable production cost for the entire life of project. This makes sense as apart from getting the product at stable price, we would also get the benefit of lower cost primarily due to cheap feed stock (gas price of US $0.77) per million Btu as against about US $3.0 per million Btu paid by plants in India along HBJ).

In some quarters, however, this is being interpreted as a sell out. They would seem to think that current low international price level, viz., US $65-85 per tonne FOB will continue to prevail and therefore, we would have paid an amount higher than this. This perception is seriously flawed as the price would be very much on the higher side in view of the past trends as well as projected tightening of global demand-supply balance.

While, fully protecting the viability of project, the restructured agreement to provide for buy-back at constant price — linked to reasonable production cost — will be beneficial to India and save considerably on subsidy outgo. In a subsidy free regime, urea supply from Oman project will be cost competitive. We can only hope that the Omanese side agrees to the new package!

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