

# An unwise dependence on fertiliser imports

**O**n consideration of all relevant factors, it turns out that the cost of making urea available whether from a joint venture project like Oman or a unit set up India, would be more or less similar. Besides, investment decisions cannot be taken purely on comparisons of financial costs, particularly for core projects like fertilisers, which have serious ramifications for the entire economy, says Uttam Gupta

**M**UCH ado is being made about Indian companies owning urea plants in countries with abundant feedstock — natural gas — and bringing back the production from these under buy-back arrangements. Feedstock/fuel cost being the second most important element in the total cost of production (next only to capital servicing charges) in a new ammonia/urea complex, this undoubtedly, is a major factor in deciding where to set up the plant.

Against this backdrop, the centre of attraction is Middle East where the price of natural gas is US \$2.5 per million Btu for plants along the HBJ pipeline. This, however, ignores the fact, that the natural gas prices in India are "artificially" inflated. Because of this, the advantage of Middle East appears to be exaggerated.

Under the existing dispensation (based on the Kelkar committee formula), the consumer price of gas is based on the cost of imported fuel oil which has no

relation to the actual cost of production. Likewise, the producer price of gas is based on the cost of production from South Bassein fields only and does not take into account the much lower cost on supplies from other fields. Moreover, in working out the per unit cost, the quantity of gas flared (about 22 per cent of total production until some time back) has been ignored; this tantamounts to producers realising the value for the gas flared at the cost of consumers.

The charges of transportation of gas through the HBJ pipeline presently at Rs 850 per thousand cubic metre, too, are arbitrarily inflated. In fixing the charge, depreciation of the pipeline has been taken at 10 years while the international practice is 25 years; the actual life of such pipelines can be as high as 50 years. Moreover, the capital servicing charges are normalised over a throughput of 18 million cubic metres of gas per day (mcmpd) whereas the capacity of the pipeline at full load is 33 mcmpd. In fact, on the basis of evidence furnished by none other than the ministry of petroleum and natural gas, the JPC worked out reasonable charges on supplies to fertiliser plants to be about Rs 466 per thousand cubic metres.

Imposition of various taxes and duties levied by the Centre and state governments further compound the effect of these unrealistically high basic price of gas and transportation charges. On an average, the royalty on gas, central sales tax (CST) and sales tax work out to about 16 per cent of the delivered price. Thus, in a total factory gate price of Rs 3,100 per thousand cubic metre, a plant on the HBJ pipeline, pays Rs 1,750 as the basic price at land fall point, Rs 850 towards transport and Rs 500 for

taxes and duties.

On making adjustment for all these factors and computing various elements of cost on a reasonable and realistic basis (this was strongly recommended by JPC and accepted by the government but, yet, to be implemented), the resultant price of gas charged to fertiliser plants in India will not look all that unfavourable.

And, by the same logic, setting up a plant in the Middle East will not look all that attractive. Even assuming, for a moment, that the gas prices will be maintained at their existing level, the economics of setting up a plant abroad vis-a-vis a similar plant in India, is not all that rosy as is often made out.

Let us consider the Oman ammonia-urea joint venture project for which the MoU was signed in August, 1994. While the nitty gritty of the gas supply agreement are yet to be finalised, the likely price may be about US \$0.5 per million Btu plus a transportation charge of about US \$0.27 per million Btu for bringing gas from the fields to the plant site. This will thus add up to the delivered price (factory gate) of US \$0.77 per million Btu. This is about US \$1 per million Btu less than the corresponding gas price in India being charged to a plant near the landfall point. In terms of per tonne cost of urea, this would imply an advantage of about US \$25 (about 25 million Btu is needed to produce one tonne of urea) for the Oman project.

This point should not, however, be viewed in isolation. Under the buy-back arrangement, the entire urea produced has to be brought back to India. Consequently, ocean freight, insurance and port charges will completely nullify this benefit. Moreover, considering that urea will have to be imported throughout the year, on a regular basis, to avoid any risk in handling, significant investment will have to be made in setting-up dedicated facilities. In sum, this will add to the effective cost of urea supplied from the project.

The impression that the investment

cost of setting up a project abroad is lower, is also not correct. The investment cost for the main project, at the prevailing prices, is reported to be about US \$1200 million. This is for a 15 lakh tonne per annum urea capacity. A similar size plant, if it is to be set-up in India, would not cost more than the equivalent of about US \$900 million despite the burden of high taxes and duties and higher financing charges. The Oman project is designed to have some surplus ammonia capacity i.e. about 2.6 lakh tonnes p.a. over and above the quantities needed to support urea production at full capacity — 15 lakh tonnes p.a. Even if one makes an allowance for this, the investment cost would still be comparable.

On consideration of all the relevant factors, it would, thus, turn out that the cost of making urea available, whether from a joint venture project like Oman or a unit set up India, would be more or less similar. Notwithstanding this, in-

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vestment decisions cannot be taken purely on comparisons of financial costs; particularly for core projects like fertilisers, which have serious ramifications for the entire economy.

Consider, for instance, the question of support to the domestic manufacturers of plant and machinery. Presently, the Indian engineering industry has the capability to meet 70-80 per cent of the requirements of fertiliser plants, almost entirely indigenously. Needless to mention that for a majority of the projects set up in India, bulk of the plant and equipment is being sourced from the Indian industry only.

For a joint venture project like, Oman,

this need not be the case — all the more so, when half of the ownership will be with the Oman Oil Company. True, in bidding for supply of equipment, design, engineering and construction work, the Indian vendors could also participate. But, the chances that bulk of business would come to them are remote. The problems of logistics and associated costs involved in moving plant and machinery all the way from India to Oman, too, cannot be wished away.

Implications from the foreign exchange angle are too important to be taken casually. Importation of urea from the joint-venture project will entail "perpetual" foreign exchange outgo. Even at the prevailing low price of US \$200 per tonne C&F, buying 1.5 million tonne urea from the Oman plant will mean US \$300 million per annum. In sharp contrast, for a project set up in India, the foreign exchange liability is much lower and restricted only to the initial one-time outgo on import of plant and machinery (only about 20 to 30 per cent of total cost).

Although, presently, the foreign exchange availability appears to be comfortable, it is likely to deteriorate with expected increase in trade deficit, reduced inflow of foreign exchange through the FIIs/GDR route and even more importantly, the increasing liabilities on servicing of the external debt. In view of this, it will not be possible to sustain fertiliser imports on a larger scale. Even assuming that the BoP situation improves at some point of time in the future, which is unlikely, it would be much better to conserve foreign exchange for meeting other essential import needs such as crude, POL, non-ferrous metals etc., and produce fertiliser indigenously using domestic feedstock.

Import of urea, on a largescale, would also run into serious problems on account of the bottlenecks in handling at the ports and transportation of the material to various destinations, predominantly to the northern parts of the country, which are high deficit areas.

In fact, recently, because of the shortage of railway wagons, not only we faced enormous problems in moving the imported material, but a majority of the plants located in north India had also to be closed down due to the resultant inability to move the product. Such problems will assume unmanageable dimensions in the event of India increasing its dependence on import of fertilisers.