Editorial

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Concessional supply of feedstock

No subsidy to fertiliser industry

The Petroleum Ministry's stance that the feedstock supplies to the fertiliser industry should be subsidised directly by the Government and not through the oil pool account is tantamount to passing the buck. Whoever pays the money, the burden ultimately falls on the exchequer, says Uttam Gupta.

TO deal with the ballooning deficit in the oil pool account (OPA), one of the proposals in the package presented by the Ministry of Petroleum and Natural Gas to the United Front Steering Committee is to do away with the concessional supplies of hydrocarbon feedstock — naphtha, fuel oil and LSHS — to the fertiliser industry.

It may be clarified that the supplies meant for use as feedstock in the main process plant alone are made available at concessional rates. The quantities used in the captive power and steam generation facilities — despite being an integral part of the fertiliser manufacturing process — are already being charged at the non-concessional rate.

Besides, even supplies to gas-based plants which are forced to use alternative feedstock due to arbitrary and unilateral cut in the supply of gas, are being charged at non-concessional rates for such uses.

In some cases, in the event of gas shortage becoming acute forcing plants to use naphtha even in the main process plant for feedstock purpose, such supplies are also on non- concessional basis. Clearly, the impression that the fertiliser industry is getting concessional supplies *in toto* is far from true.

Notwithstanding the above, the implementation of the Petroleum Ministry proposal to charge even the feedstock supplies at the non-concessional rate will mean a further steep increase in the cost of production of the fertiliser plants.

At present, the concessional price of naphtha after the hefty increase in July 1996, is Rs. 4,840 per tonne on ex-refinery basis. Including freight and sales tax, the cost to the fertiliser plant at the factory gate works out to about Rs. 5,500-5,800 per tonne depending on the location of the plant, the freight cost and the sales tax, which varies among States.

The prevailing non-concessional price of naphtha is Rs. 6,684 per tonne on ex-refinery basis. Including excise duty, 10 per cent freight, and sales tax, the cost of naphtha at the factory gate would work out to about Rs. 9,000 per tonne. Thus, the implementation of the proposal would imply a hefty increase in the cost of naphtha to the fertiliser units by a whopping Rs. 3,200-3,500 per tonne.

Though manufacturers have the option of importing naphtha at zero custom duty, at the prevailing C&F landed cost of $235 per tonne, the cost at the factory gate will be about Rs. 9,000 per tonne at the bare minimum, that is, for a plant located on the coast. For a plant in the hinterland, it would be well over Rs. 10,000 per tonne apart from problems of handling and transportation which make it an unattractive option.

Taking an average 0.6 tonne of naphtha needed to produce one tonne of urea, the steep increase in the fuel cost would mean a jump in the production cost of urea by Rs. 1,920-2,100 per tonne. In view of the control on the selling price, this would lead to a corresponding rise in the subsidy payable under the retention pricing and subsidy scheme (RPS). On a total production of about four million tonnes from naphtha-based plants, the consequential increase in the subsidy would be about Rs. 800 crores.

The concessional price of fuel oil is Rs. 3,916 per tonne, on ex-refinery basis, which works out to about Rs. 4,500 per tonne at the factory gate depending upon the location, rate of local taxes and so on.

At the non-concessional rate of Rs. 6,314 per tonne ex-refinery, the corresponding cost at the factory gate would be about Rs. 7,000 per tonne leading to a Rs. 2,500 per tonne rise over the existing level. Taking 0.6 tonne of fuel oil needed to produce one tonne urea, the consequential increase in the cost of the latter would be about Rs. 1,500 per tonne having to be reimbursed as additional subsidy under the RPS.

On a total production of about 2.22 million tonnes from fuel oil/LSHS-based plants, the extra subsidy outgo would be about Rs. 330 crores.

Clearly, the Petroleum's Ministry's move would result in an increase in the subsidy on urea by about Rs. 1,130 crores. This would also run counter to the Government's avowed policy of containing the burgeoning subsidy. In fact, the consequential saving of about Rs. 600 crores would be more than fully nullified if the proposal is implemented.

Though the RPS provides for full compensation of the effect of hike in administered prices, including feedstock, the manufacturers too would suffer a substantial loss. This is because adjustments in the RP to reflect the increase in the production cost and release of payment on the revised RP is a time consuming process.

For instance, following the steep hike in the prices of naphtha/fuel oil/LSHS from July 3, 1996, the RP was adjusted only recently, that is, after 11 months, to reflect the consequential increases in production cost. Apart from liquidity problems leading to loss of production, interest on the amount withheld alone is a substantial loss eroding profitability.

Already, with the reasonable cost of production and distribution of about Rs. 6,500 per tonne on a weighted average basis being substantially higher than the controlled selling price, that is, Rs. 3,660 per tonne, the manufacturers are potentially vulnerable.

In the event of any major policy change, such as urea decontrol or replacement of the RPS by import parity pricing, there could be a serious threat to their continued viability. The pricing of feedstock on non-concessional basis would further increase the production cost steeply and in view of selling price not keeping pace, the manufacturers would become even more vulnerable.

For producers of decontrolled phosphatic fertilisers, such as CFL or FACT, which use domestic ammonia supplies from plants based on naphtha/fuel oil as feedstock, the situation is even more grim. In the absence of the RPS and the concession amount under the scheme of *ad hoc* concession fixed on a uniform basis for the entire industry, such manufacturers remain unprotected.

The increase in production cost because of the increase in naphtha/fuel oil prices cannot be passed on to the farmers either, as the selling prices of fertilisers too are fixed by the Government uniformly. Switching to the use of imported ammonia also will not provide any relief as, in that case, indigenous investment will remain unutilised leading to a significant loss by way of standing charges.

In this context, it may be pertinent that FACT's ammonia revamp/expansion project at Alwaye (Kerala) involving the augmentation of the capacity from 355 tonnes per day to 900 tpd, and likely to be commissioned shortly by September, is based on naphtha.

Consequent to the steep increase in naphtha price, the cost of producing ammonia from this plant will increase sharply, leading, in turn, to a corresponding increase in the cost of FACT products — Factamfos 20:20 — and thus price them out. Alternatively, if it continues to use imported ammonia for maintaining the competitiveness of its products, investment in its own ammonia plant will go down the drain.

The lower price of feedstock charged to the fertiliser plants is not a concession to the industry as at whatever level the prices are fixed, it gets reflected in fixing the RP and payment of subsidy on that basis. If the feedstock prices are fixed at a higher level by charging a non-concessional price, the RP will be adjusted accordingly which, in turn, would increase the subsidy amount payable by the Government.

Thus, by maintaining feedstock prices at a low level, the Government only keeps the subsidy on fertiliser under check and, in no way, can the lower price be construed as a concession to the industry.

During the 1990s, so far, even the so-called concessional price on supplies for the fertiliser industry has been raised on four occasions — October 1990, July 1991, September 1992, and July 1996. The cumulative effect of these has been an increase of 145 per cent in the price of naphtha, 175 per cent in the case of fuel oil and 177 per cent for LSHS. Despite this, at the present high level of Rs. 4,840 per tonne of naphtha, the Petroleum Ministry's contention is that these are heavily subsidised. On what basis?

The Ministry has sought to justify this on the basis that the price for non-fertiliser users is higher, that is, naphtha at Rs. 6,684 per tonne. This is illogical. Whether or not any product is subsidised should be seen in relation to the reasonable cost of production instead of relating it to an artificial price.

The price charged to other industrial users is artificially high, on which the refineries make substantial profits. Such comparison must be avoided as it leads to a completely misleading picture.

In fixing prices of the petroleum products, including naphtha, fuel oil/LSHS, there is total lack of transparency. This leads to cost padding, pricing on actuals devoid of any norms and protection of inefficiencies in project implementation and resultant time and cost overruns.

This has to change. The retention margins of the refineries should be fixed on the basis of efficiency norms and the process made transparent. Slippages in the setting up of refinery plants and projects for other infrastructure for handling, marketing and distribution should be avoided to keep the investment cost low.

That would help in containing the reasonable cost and throw up a correct picture of, whether at the prices charged to the fertiliser industry, it is subsidised or not.

Notwithstanding the above, if the cost of feedstock still turns out to be higher, then also, it would be more cost- effective to subsidise at the level of input stage. This is because if the prices are increased to reflect the full cost, the cost of production of fertiliser will increase more than proportionately due to increase in the element of sale tax — charged on an *ad valorem*/percentage basis — and the additional cost of working capital having to be allowed under pricing.

The Petroleum Ministry's stance that the feedstock supplies to the fertiliser industry should be subsidised directly by the Government and not through the oil pool account is tantamount to passing the buck. Whether the money is paid through the former or the latter, the burden ultimately falls on the exchequer. In view of this, the Government should take an integrated and coordinated view and maintain the feedstock prices to fertiliser industry at the existing concessional level as this is indeed, the most cost effective option.

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