Editorial

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ERC/DoF proposals on uniform concession scheme

Putting cart before horse

The Expenditure Reforms Commission/Department of Fertilisers package is a typical case of "putting the cart before the horse". A pre-requisite for a viable scheme of uniform pricing is to provide a 'level-playing field' to all plants within a group. The Government should ensure this by facilitating supply of energy inputs to them at a uniform price, says **Uttam Gupta**.

THE Group of Ministers (GoM), under the Chairmanship of Mr K. C. Pant, Deputy Chairman, Planning Commission, is now gearing itself to give shape to its recommendations on the long-term policy for the urea industry within the framework of the recommendations of the Expenditure Reforms Commission (ERC).

The ERC had recommended replacement of the existing unit-wise retention price scheme (RPS) by a group-wise 'uniform' concession scheme. Under the latter, it proposed 'five' groups — pre-1992 gas-based plants; post-1992 gas based plants; plants based on naphtha; plants based on fuel oil/LSHS and plants on mixed feedstock. It suggested taking a 'weighted average' of the retention prices — under the RPS — for determining the concession under each group. These were intended to cover the period February 1, 2001, to March 31, 2002, also referred to as Stage-I.

In Stage-II, beginning April 1, 2002, the ERC proposed a reduction in uniform concession for each of the three non-gas groups based on specified targets of energy consumption — seven million kilo calories per tonne urea for plants in the naphtha and mixed feedstock group and 9.75 million kilo calories per tonne urea for plants in the fuel oil/LSHS group. For plants in the gas group, it recommended reduction in capital-related charges (CRC).

In Stage-III, beginning April 1, 2005, the ERC recommended further reduction in concession for plants based on naphtha and mixed feedstock on account of their switch-over to the use of LNG. Finally, in Stage-IV, beginning April 1, 2006, it proposed complete withdrawal of concession for all plants other than plants based on LNG. For the latter, it proposed FDCR (feedstock differential cost reimbursement) of Rs 1,900 per tonne.

At the farmer's level, the ERC recommended an increase in the selling price of urea by 7 per cent per annum beginning February 1, 2001, to reach Rs 6,900 per tonne by 2006. At this level, the price will be equal to the projected import parity price (IMPP) of urea. Clearly, the emphasis was on 'phased' de-regulation of the farmers' price to prevent adverse effect on fertiliser consumption and, in turn, production of cereals and other agricultural commodities.

Recently, the Department of Fertilisers (DoF) is reported to have submitted to the GoM a modified version of the ERC package. Under it, the DoF has proposed 'seven' groups — pre-1992 gas; post-1992 gas; pre-1992 naphtha; post-1992 naphtha; plants based on fuel oil/LSHS; plants based on mixed feedstock; plants whose retention price in the respective group is very high or very low (these have been branded as 'outliers').

For plants in the 'six' groups other than 'outliers', the DoF has proposed determination of the concession under each in the same manner as recommended by the ERC. For arriving at the concession for 'outliers', it has suggested taking the 'mid-point' of the weighted average of the retention prices of all plants in the respective group, on one the hand, and the retention price of the 'outlier', on the other.

The concession rates as determined above are intended to cover the period July 1, 2002 to March 31, 2004, also referred to as Stage-I. In Stage-II — April 1, 2004 to March 31, 2006 — the DoF has proposed reduction in the number of groups to 'five'. These groups are the same as recommended by the ERC. The DoF has not made any proposal for Stage-III and Stage-IV as the position on the availability and pricing of LNG is uncertain.

In the averaging principle, there are bound to be gainers and losers. For the gainers, the DoF has recommended that, of the gain up to Rs 500 per tonne, 25 per cent will be mopped up. For gain in excess of Rs 500 per tonne, the mop up will be 50 per cent. The money collected in this manner will supplement a Fertiliser Industry Development Fund (FIDF), which the Government proposes to set up with a corpus of Rs 200 crore to finance energy improvement schemes by various units.

The ERC had recommended that concession in the non-gas groups will be reduced to reflect reduction in IMPP of feedstock on a quarterly basis. However, in case of increase in IMPP, it proposed increase in selling price on a half-yearly basis. On the other hand, the DoF has recommended adjustment in concession amount 'only' to reflect increases/decreases in IMPP of feedstock. These adjustments will be made every quarter.

To take care of the variations in costs other than the cost of feedstock — overheads, wages and salaries, freight, marketing and selling expenses — the ERC had proposed applying 50 per cent of the increase in whole sale price index (WPI) to the selling price. The DoF, on the other hand, has proposed applying 50 per cent of the increase in WPI to the weighted average retention price of the relevant group.

The viability of the ERC/DOF package needs to be tested in terms of the basic premise on which the suggested groups have been made. A group has to be 'homogeneous' at least in terms of the 'uncontrollable' factors of cost. One such major factor is the delivered cost of energy at the plant site. Within any given group, this varies widely due to the sheer factor of location and resultant differential effect of freight and local taxes especially sales tax.

In the pre-1992 gas group, the plants along the HBJ pipeline have been clubbed with those at the landfall point or drawing on-shore gas. The former pay a hefty transport charge of Rs 1,150 per thousand cubic metre to Gas Authority of India Ltd (GAIL). On the other hand, the latter either do not incur any cost on this score or the charges are small when compared to the plants along HBJ.

Due to the overall shortage of gas, all plants based on gas are forced to use alternate feedstock/fuel — naphtha, fuel oil — to ensure optimum utilisation of the capacity. In view of the latter being more expensive, this increases the effective cost of energy. And, since, the shortage in the supply of gas varies widely across plants leading to supplementation by naphtha/fuel oil to varying degree, the effective cost of energy also varies.

In view of above, none of the groups is 'homogeneous' even in terms of the delivered cost of energy. And, yet, if all plants in a group are given concession on the basis of a weighted average of retention prices, this will 'unjustifiably' penalise units facing high cost due to high cost of energy. On the other hand, a unit having low cost will make a 'fortuitous' gain. The proposed partial mopping up of the gain of gainers is an indirect admission by the DoF that the principle of averaging is flawed.

The term 'outlier' gives an impression as if the plants with very low retention prices are highly efficient, whereas those with high retention prices are highly inefficient. This is misleading. These extreme situations arise primarily because of the factors beyond the control of the units. For instance, in the pre-1992 gas group, the retention price of HFC-Namrup is the lowest due to the highly subsidized price of gas.

In the context of allowing escalation/de-escalation to reflect variations in IMPP of feedstock also, serious distortions will arise under the averaging principle. This is because the quantum of increases/decreases will vary due to differential effect of taxes and energy mix. Allowing increase on the basis of the lowest number (this was proposed under HPC (1998) package) will make the situation even worse, especially for plants facing the maximum increase.

The ERC/DoF package is a typical case of "putting the cart before the horse". A pre-requisite for a viable scheme of uniform pricing is to provide a 'level-playing field' to all plants within a group. The Government should ensure this by facilitating supply of energy inputs to them at a uniform price. This will require 'uniform' basic price, 'equalised' freight and 'uniform' sales tax for all energy inputs including naphtha, gas, fuel oil and LSHS.

Several State governments levy special taxes — purchase tax, turnover tax etc. — which cannot be passed on to the consumer as per the relevant Act. These have the inevitable effect of increasing the cost of production of the units located in these States, putting them at a disadvantage under a uniform pricing dispensation. The Centre should prevail upon the concerned States to abolish these special taxes. Only after this should the Government think of implementing a group-wise uniform concession scheme.

This will ensure that, under the averaging principle, the gain or loss of any plant will reflect its efficiency/inefficiency in operations. Units handicapped by old technology/plant and machinery may be given one-time capital subsidy for undertaking necessary investment in revamp and modernisation for raising efficiency to the desired level.

The Government should strictly act on the ERC recommendation for increasing the selling price of urea in a phased manner. While deciding on the complete withdrawal of concession from April 1, 2006, the ERC proceeded on the assumption of no increase in the price of domestic gas. But the Petroleum Minister, Mr Ram Naik, wants a steep increase in the price. The Government should avoid this. On the other hand, if, this is allowed, it will have no option but to continue with concession support even after April 1, 2006!

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