ERC's nutrient-less package

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THE GOVERNMENT'S decision to implement the recommendations of the Expenditure Reforms Commission (ERC) for phased decontrol of urea by 2006 — announced in the 2001-02 Budget — has given rise to several questions which need to be addressed. This is important as the new policy will have a far-reaching impact on the continued health and growth of the industry and the well-being of millions of farmers and consumers of foodgrains.

At the outset, it may be recalled that in July 2000, Mr Suresh Prabhu, the then Minister for Chemicals and Fertilisers, had released a background paper on the Long Term Fertiliser Policy at a Ficci conference. The paper gave a comprehensive and exhaustive account of what the Government proposed to do in all major areas — selling price, producer price, distribution controls, availability and pricing of feedstock, planning for demand and supply and so on.

Mr Prabhu had also sought the views of all affected parties, including industry, farmers, State governments and even proposed a number of seminars to facilitate full discussion and generation of useful ideas/inputs. In short, the paper was intended to be the key document on the basis of which, the New Fertiliser Policy was to be formulated and announced. How come, then, the Finance Minister announced the introduction of a new policy on the basis of the ERC report, which came as a bolt from the blue?

According to a report in *Business Line* (March 23, 2001), the Chief Ministers of Gujarat, Kerala, Madhya Pradesh, Uttar Pradesh and West Bengal wrote to the Finance Minister/Prime Minister, expressing reservations over the implementation of the ERC recommendations, especially with regard to the impact on farmers and poor consumers of foodgrains.

And, yet, by deciding to implement the ERC report as it is, the GoI has shown apathy to the concerns of the states! In a letter to Mr Dipankar Mukherjee, Rajya Sabha MP, on March 2, the Minister for Chemicals and Fertilisers, Mr S. S. Dhindsa, had stated that the Government was in the process of formulating the new policy. This was despite the FM having already announced the new policy on February 28, 2001. This reveals the lack of coordination between the ministries concerned.

In the context of formulating the New Fertiliser Policy, while containment/reduction of subsidy is an important issue, the need for ensuring continued health and growth of the industry, on the one hand, and increasing fertiliser consumption and production of foodgrains and other agricultural crops, on the other, cannot be wished away. Unfortunately, the ERC has remained obsessed with the former even as the latter has been given only lip service. A focussed look at some of the key recommendations will clearly bring this out. From the farmers' point of view, apart from timely supply of the material in required quantities, a key factor is the price. In this regard, the ERC has recommended an increase of 7 per cent per annum beginning 2001 up to 2006. The modest hike is to prevent any sudden adverse impact on farmers and prepare them to face the situation of eventual decontrol without much pain. However, for reasons best known to it, the Government has refrained from implementing this.

A major cause for concern is the parallel recommendation in regard to adjustment for changes in the price of feedstock. The ERC has, thus, recommended that whenever the IMPP of feedstock decreases, the concession amount — under group- wise concession scheme — will be reduced. These adjustments will be made on a quarterly basis. But when the IMPP increases, manufacturers will be required to pass on consequential increase in production cost to the farmers. These adjustments will be made on a six-monthly basis.

The prices of feedstock have been rising, especially in the 1990s. The trend is likely to continue in the years ahead. In view of this, adopting the ERC recommendation will lead to corresponding increases in the selling price of urea. In case, however, there is resistance from farmers, the extra cost on account of the increase in IMPP of the feedstock will cripple the producers. In the medium-to-long run, this will hit farmers by way of reduced supplies.

Already, there are indications of a steep increase in the price of gas, consequent to the reported move to remove the existing ceiling of Rs 2,850 per thousand cubic metre on the basic price of gas and establish its linkage to international price of a basket of internationally-traded fuel oils at 100 per cent. The likely increase could be about $2 per million Btu, which will raise the production cost from gas-based plants by about Rs 2,300 per tonne.

Taking the above increase as pass through — based on the ERC recommendation — the price to farmer will increase from the existing Rs 4,600 per tonne to Rs 6,900 per tonne in 2001-02 (depending on when the gas price hike takes effect). This, incidentally, is the price which will prevail in 2006, under the normal situation of only 7 per cent increase per annum for six successive years. The urea plants are based on a wide variety of feedstock — gas, naphtha, fuel oil, LSHS — the prices of which move at differential pace. To assess what the ERC package has in store for industry, a look at the manner of determining the concession rate. For each group, this is arrived at by taking a weighted average of retention prices (RP) of plants under existing dispensation. Within the naphtha group, let us assume the RP as Rs 11,000, 12,000... 15,000 per tonne. And, the weighted average of these works out to, say, Rs 13,000 per tonne.

Now, under the concession scheme, all plants in this group will get Rs 13,000 per tonne, leading to loss for units whose RP is higher than this and gain for those whose RP is lower. These gains/losses could run into several crores of rupees, being as high as about Rs 150 crore in some cases. And, yet, there will be no savings in subsidy which merely gets re- distributed from one group to another.

The ERC's argument that the scheme will induce units to improve efficiency and reduce production cost is not valid. This is because, within any group, the cost of feedstock varies widely; in the case of naphtha, the difference between minimum and maximum is as high as Rs 3,000 per tonne. The ERC should have addressed the prime causes — differences in ex-refinery price, freight and local taxes, leading to these variations. Skirting these, it has clubbed all plants together, thereby unjustifiably penalising those who suffer from the handicap of having to pay more.

> The implementation of the Expenditure Reforms Commission recommendations will spell disaster for the fertiliser industry and the farmers. The crux of the problem is that the ERC has appropriated to itself the role of a regulator and wants units to do precisely what it thinks is right.

Having determined the concession rates using the above methodology — Rs 8,400 per tonne for plants in the naphtha group, the ERC does not stop there. It recommends a further reduction of Rs 1,900 per tonne to account for the substitution of actual feedstock cost to the units by the IMPP price of feedstock. While this aggravates the loss of losers under the averaging principle, it also nullifies to a considerable extent the potential gain of gainers.

It is illogical to make adjustment on account of IMPP when fertiliser units are not actually getting feedstock at that price. The observation in the ERC report that units should make efforts to procure feedstock at this price is not valid, as under the Exim Policy, they are not even permitted to freely import naphtha. Even domestic oil companies charge prices which are substantially higher than warranted on the IMPP basis.

Reportedly, the Government is contemplating to ensure supplies of feedstock at IMPP plus 4 per cent sales tax. However, given the pace at which things move within the bureaucracy, it could take time before units actually start getting feedstock at this price. And, considering that the new policy is to take effect from April 1, 2001 — as announced by Mr Yashwant Sinha in his Budget speech — the units will be put on the block.

Let us take a look at the method used for working out the quantum of reduction in concession on account of substituting IMPP in place of actual cost of feedstock. For this purpose, the differential in cost (expressed in Rs. per million K cal) is multiplied by the total energy consumed per tonne of urea. Thus, taking the former as Rs 100 per million K cal and the latter as 8 million K cal, the reduction will be Rs 800 per tonne urea.

The method is flawed as it assumes that the entire energy requirements of the plant is sourced from the relevant feedstock for the group in which it falls — naphtha in the instant case as against actuals being significantly lower. Depending on the plant configuration, only half/two-third of the total energy is supplied from naphtha, the balance coming from use of fuel oil/coal or power sourced from the SEBs. This results in the reduction of a much larger quantum than justified.

In the above example and taking only 50 per cent of energy supplied from naphtha — 4 million K.cal — the reduction on account of the differential of Rs 100 per million K cal should only be Rs 400 per tonne urea. Against this, according to the method adopted by the ERC, the reduction will be Rs 800 per tonne. In other words, there will be an excess disallowance of Rs 400 per tonne, which is totally unjustified.

Even as the Finance Minister has for now implemented only the recommendations pertaining to Stage-I (2001-02), the ERC has recommended further reductions in concession in Stage-II due to tightening of energy consumption norms and in Stage-III on account of switchover of plants based on naphtha and mixed feedstock to LNG. This assumes that units will undertake the required investments in revamp/restructuring to reduce energy consumption and enable use of LNG. Having received a drubbing in Stage-I itself, one wonders whether they will survive to face the onslaught in Stage-II and III!

The implementation of the ERC recommendations will spell disaster for the fertiliser industry and the farmers. The crux of the problem is that the ERC has appropriated to itself the role of a regulator and wants units to do precisely what it thinks is right. If the perception is that producers should face competition, this would be a less painful option than a "group of experts" deciding their fate based on theoretical considerations.

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