Editorial

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THE HINDU BUSINESS LINE

Have fertiliser units made unintended gains?

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A FEW months back, the Government announced an investigation by the CBI into the alleged under-declaration of capacity by urea manufacturing units under the retention price scheme (RPS). If this is established, according to the Law Ministry, proceedings can be initiated against the units.

The key issue is whether the owners of the plants concealed any facts/ information. All units (except some recent expansions) were set up when the fertiliser sector was under a controlled/ licensing regime. Thus, the plant size, location, feedstock, technology, and even consultants were decided on by the Government. Import of major equipment — under the International Competitive Bidding procedure — was cleared by an Empowered Committee.

The Government and its agencies were also involved at various stages of project implementation. Thus, projects in the public/ cooperative sector were approved by the Public Investment Board and the Cabinet Committee for Economic Affairs.

After commissioning, the plant is referred to the Fertiliser Industry Coordination Committee (FICC), under the Department of Fertilisers, for fixing the retention price. This involves a detailed examination of all financial and technical parameters.

The producer has to have the production plan approved by the Government for allocation under the Essential Commodities Act. Besides, urea production is reviewed/ monitored on a weekly basis. The units are also required to submit monthly production data to the FICC to claim subsidy. Thus, total transparency in a unit's operations is ensured. The perception that capacity was under-stated was formed on the basis of the reported high capacity utilisation of the units concerned. But high production/utilisation levels are not a sudden development.

During the 1990s, until 1996-97, (except in 1993- 94), imported urea was costlier than domestic supplies. Thus, from the subsidy angle, the Government encouraged units to maximise production. Had the issue of gold-plating been raised then, domestic production would have been restricted, thereby leading to much higher subsidy payments on imports!

Have the units made any unintended gains? Despite operating at a high capacity utilisation, generally, they have recorded lower returns, or just close to 12 per cent post-tax (this is the assured rate under pricing at normative levels). Had they operated at the normative level, returns would have been meagre and, in some cases, there could have been losses!

With effect from April 1, 2000 the retention prices of these units were reduced, based on an interim re-assessment of capacity. This is already affecting their bottomlines. In fact, Tata Chemicals is reported to have made a loss during April-June 2000. The situation is fraught with the risk of these units turning sick despite high efficiency in operations.

Notwithstanding the above, the zeal to somehow show that excess payments were made is best illustrated by the manner in which the High-Powered Committee (1998) did the relevant computation. Instead of proportionately reducing the fixed charges, including the capital-related charges, it worked on the retention price, which includes variable cost too. This flawed method resulted in artificially inflating the impact. Ironically, even as the potential gains from high capacity utilisation are blown out of proportion, there is not a whisper about the substantial under-recovery in various cost segments, including those on account of significant disallowance in investment cost and other fixed charges. This results in a distorted perception about the financial performance of urea units.

A holistic view of the gains and losses reveals that, far from reaping any bonanza, urea manufacturers have not even got what they should have. If the present approach continues, the day is not far when plants may have to face closure. This has to change, as the country simply cannot afford the huge loss in domestic production capacity.

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