High feedstock cost hits competitiveness

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RECENTLY, an editorial in a leading financial daily made the point that the country would be better off if it did not have the high-cost domestic naphtha and fuel oil-based urea plants. These plants are under attack from the Government as well. For instance, the Background Paper on Long-term Fertiliser Policy, released by the Department of Fertilisers in July 2000, stated that they will not survive under the WTO regime.

Together, these plants account for 40 per cent of the country's total urea production capacity of 20.0 million tonnes per annum. Currently, the domestic supply more or less equals the demand. In view of this, there was no import of urea last year and, this year, the import so far was only 0.22 million tonnes. In case, however, these plants are closed, we will have to import a whopping 8.0 million tonnes!

The international price of urea depends primarily on the global demand-supply balance, which is heavily influenced by imports from India and China. In recent years, the price has been low as, apart from virtually no import from India, even China has not imported any quantity. This, in turn, is because both these countries have become more or less self-sufficient in domestic availability.

Now, if we were to import 8.0 million tonnes,the international price is bound to rise sharply. In 1995-96, the C&F cost of imported urea was $240 per tonne. Even during 1996-97, when imports were 2.4 million tonnes, the cost was $210 per tonne. The highest price ever paid by India — $300 per tonne was in the mid-1970s, when imports formed 50 per cent of our requirements.

We should also not be oblivious of the impact of WTO commitments on the fertiliser industry in China. As is the position in India, in China too, a substantial portion of the domestic production capacity is on high-cost plants based on naphtha and fuel oil. Under the liberalised WTO-compatible regime, this will be rendered unviable, leading to significant increase in imports by China as well. Ignoring the past experience, if the Government still aims at high imports, the international price will once again shoot up. It could be any level that the global suppliers could extract from us. While, this would be well above the psychological barrier of $300 per tonne, even at this level, the cost of imported urea at the farmers' doorsteps would be about Rs 15,000 per tonne. This is significantly higher than the cost of supply from domestic naphtha-based plants.

Some experts, however, feel that the international price will not rise. They argue that when the global suppliers come to know that India plans to import large quantities on a sustained basis, they would set up additional capacity. This, by itself, presupposes a significant increase in the international price, leading to better realisation and, in turn, higher returns on investment. In other words, we will have access to additional supplies only at significantly higher cost.

When will the additional capacity materialise? Invariably, it takes about four years — from conception stage to commissioning — for a new project to take shape (for joint ventures abroad, it could be much longer, as amply demonstrated by the experience with the joint venture in Oman). As against this, the requirement for additional quantities of urea being 'immediate', we are bound to face a situation of steep increase in price as well as problems of availability.

We also need to consider the constraints of handling at the port, timely evacuation of the material and its movement and distribution to consumption points spread all over the country. In the past, we have had a taste of these whenever, imports were in excess of 2.5 million tonnes, as in 1995-96. According to the Planning Commission, the ports have a capacity to handle a maximum of about 8.0 million tonnes of fertiliser material!

In view of the above, the policy-makers need to shed their optimism on imports.

If, on the other hand, they are worried about the high production cost from the naphtha and fuel oil based plants in India, then we need to look objectively for the reason. This is primarily because of the high cost at which feedstock is supplied to these plants. Currently, the cost of naphtha works out to about $6.0 per million Btu (last year, it had gone up to a high of $8.0 per million Btu).

Thus, for an efficiently operated plant — that is, using about 30.0 million Btu of energy for a tonne of urea — the cost of feedstock/fuel alone is about $180.0 per tonne. The majority of the plants based on naphtha are fully depreciated. In view of this, other operating costs (capital related charges and other fixed costs) are low, at about $50 per tonne. This leads to an overall production cost of $230 per tonne.

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If only naphtha were made available to these plants at the same price as domestic gas — $2.5 per million Btu being the price charged to plants along HBJ pipeline) — the cost of feedstock/fuel would decline to $75.0 per tonne.

The overall production cost from these plants would, therefore, be $125 per tonne. Such urea would be able to compete with imported urea, even at the current depressed price of $120 per tonne.

Instead of driving the naphtha and fuel oil based plants in India towards closure, the Government should endeavor to remove the handicap facing them. It should direct oil companies under its control to bring down the price of feedstock to a level at par with gas. Alternatively, it should arrange for the supply of domestic gas or imported LNG to facilitate their switchover to use of gas — as recommended by the Expenditure Reforms Commission — so that the plants stay viable and competitive in a free market regime.

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