Joint venture urea project in Oman

Buyback agreement needs a fresh look

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THE Government of India is reported to have commited to buy back the entire quantum of urea produced — about 16 lakh tonnes per annum — by the joint venture ammonia/urea project in Oman. Two Indian fertiliser companies — IFFCO and KRIBHCO — hold 50 per cent of the total equity in the joint venture, the other 50 per cent being held by the Oman Oil Company (OOC).

In Oman, gas is available in plenty and is inexpensive. But this in itself will not ensure that the cost of Oman urea will be lower than indigenous urea. This is because the cost components other than feedstock/fuel — the capital related charges (CRC) and other fixed costs — account for 40-50 per cent of overall production cost, where the former is at a disadvantage.

Besides, one cannot ignore the cost of bringing urea from Oman to Indian shores (handling at the loading port, ocean freight and insurance), handling at the Indian port and internal transportation to the consumption areas. Taking a holistic picture, the Oman urea may be no cheaper than domestic urea despite the benefit of low gas price.

Initially, purchase of Oman urea was contemplated at the prevailing international price. However, this was not acceptable to the lenders, who insisted on a stable revenue stream and guaranteed returns. The Government has obliged by giving a guarantee for purchase of entire production at a pre-determined cost-plus price.

While this has put the project in absolutely safe territory, one is not sure whether the Government has carefully evaluated the arrangement from the Indian perspective. Here are some of the imponderables that need to be addressed.

Who will procure urea from the Oman joint venture?

Following the necessary amendments in the Export Import (Exim) Policy from April 1, 2001 — as per India's obligations under the World Trade Organisation (WTO) — urea can only be imported by designated State Trading Enterprises (STEs). The Government has nominated three STEs — Minerals and Metals Trading Corporation (MMTC), the State Trading Corporation (STC) and Indian Potash Limited (IPL) — for this purpose.

The supply from a plant located abroad is fundamentally in the nature of imports. It is, therefore, as imports that the supply of urea from Oman will be treated. This basic position will not change simply because the Government has decided to consider this as part of indigenous supply under the draft Long-Term Fertiliser Policy. Consequently, only the designated STEs can bring Oman urea to India.

Under the erstwhile QR regime, in vogue until March 31, 2001, the Government could decide the modalities of imports at will and give appropriate directions to the designated canalising agencies (as they were then called). After removal of QRs, it has to re-work the arrangements to achieve compatibility with WTO.

Under Article XVII of the WTO Agreement, STEs are required to undertake imports on commercial considerations and conduct these in a transparent and non-discriminatory manner. In other words, they have to call for global competitive bids and give equal opportunity to all suppliers while procuring the material.

The thrust of Article XVII is thus on the principle of non-discrimination between various suppliers. Now, if the STE is required to observe this condition by giving equal opportunity to all suppliers, the off-take of the entire supplies from the Oman joint venture (1.6 million tonnes per annum) may not be automatically guaranteed. Why?

The international price of urea fluctuates widely depending on prevailing global demand supply situation. Against this backdrop, situations will arise when the price quoted by other suppliers is less than the fixed price offered by Oman joint venture. As a result, some quantities will inevitably go to the former.

This means that the commitment for buy-back cannot be met in full.

If, on the other hand, STEs zealously try to procure the entire 1.6 million tonnes per annum from the Oman joint venture (as committed under the buy-back agreement), they would have ended up denying other exporters the opportunity to supply the material at a lower price, thereby violating the provisions of Article XVII.

It may be argued that purchase from the joint venture is fundamentally different from any normal transaction. This point of differentiation arises because Indian companies are co-owners of the project. By virtue of this special arrangement, we need not go through the process of competitive bidding. This argument is flawed.

The designated STEs for urea imports are MMTC, STC and IPL whereas the co-owners of the Oman joint venture are IFFCO/KRIBHCO. It is the latter who have a special relationship with the joint venture, and not the former. And as IFFCO/KRIBHCO are not involved in the process of importation, the special relationship argument falls flat on its face.

What treatment does the Government give the Oman urea after it has been brought to India?

This question, too, has significant implications from the WTO angle. In order to assess these, we need to take a look at the policy environment covering the sale, distribution and pricing of urea.

All urea sales to the farmers — irrespective of the source of supply — have to be made at low price controlled by the Government. Since the cost of production and distribution is higher than this, the manufacturers are compensated for the shortfall as subsidy under the Group Concession Scheme (the erstwhile Retention Price Scheme prior to April 1, 2003).

Since the cost of supplying imported urea — including C&F price plus handling and distribution — is also higher than the selling price, imports will be viable only if the difference is covered by subsidy support. Indeed, this is what the Government was doing all along until a couple of years ago. Since the subsidy was meant to cover the respective cost of supply from each source, the Government was in fact running a scheme of differential concession support. This did not, however, raise any eyebrows as urea imports were under the QR regime until March 31, 2001.

After removal of QRs from April 1, 2001, the Indian policy regime has come under the WTO scanner. But the issue has not been precipitated for the simple reason that since 2001-02, no urea imports were made for direct sale to the farmers. In fact, the entire demand has been met by supply from domestic industry.

Currently, the designated STEs import urea only to the extent required by manufacturers of complex fertilisers, who use it for fixing nitrogen in these products. Since such sales are made at the import parity price (plus the service charge of STE), there is no subsidy implication.

To oblige lenders, who insist on a stable revenue stream, the Government has committed to buying the entire volume of urea produced each year by the joint venture project in Oman at a pre-determined price. While this has put the project in safe territory, the Government seems not to have carefully evaluated the arrangement from the Indian perspective.

The scenario will change when Oman urea starts flowing into the Indian market in 2005. The quantities being a huge 1.6 million tonnes per annum, manufacturers of complex fertilisers alone cannot consume these. The bulk of the Oman urea will, necessarily, have to be sold directly to the farmers.

Since the sale of Oman urea has to be at low, uniform, controlled price, the excess of the cost of supply over this has to be subsidised to prevent loss.

The quantum of support on it will be different than the concession on domestic urea as each source is compensated on the basis of its respective cost. The resultant differential concession — this time, under a QR-free regime — could attract attention at the WTO.

Under the WTO, if a member Government gives financial support/concession to the domestic manufacturers at a rate higher than on import of the same product, this is tantamount to discrimination against imports and, therefore, violates Article III-4 dealing with National Treatment. In the case of DAP, where the Government already runs a scheme of differential support involving concessions to the domestic industry at a higher rate than concessions on imports since July 1996, the US (it has a major stake in exporting DAP to India) is seriously considering action at the WTO.

Now, if the WTO accepts the US contention that the Scheme violates Article III-4, our DAP industry could be in trouble. Extending the same principle to urea (this will be applicable from 2005 onwards when Oman urea would start coming in), the high-cost domestic manufacturers of urea could also slip into an unsafe zone.

In the context of DAP, some legal experts hold the view that in case a differential concession scheme is held incompatible with WTO stipulations, the Government could still ensure compatibility by completely withdrawing concession support on imports and giving concession exclusively to the domestic manufacturers. Their contention is that this is permitted under Article III-8-b.

If the Government gives concession only to domestic manufacturers, Oman urea will not be entitled to concession (being imported material) and will, therefore, be rendered unviable. We will thus have a situation of being between the devil and the deep sea. The Government can either safeguard high-cost domestic units or Oman urea, but cannot take care of both!

Some experts have advocated treatment of the entire sale of urea by domestic manufacturers as government procurement. This way, the Government could get away with differential concession. But this route too is not without problems as government procurement is one of the four Singapore Issues and will come under the WTO sooner than later.

As it is, we face the daunting task of having to protect our high-cost domestic urea units in a WTO-compatible scenario.

The agreement for guaranteed buy-back of Oman urea will only complicate matters further. The Government would do well to take a fresh look at the terms to ensure that our national interests are not compromised.

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