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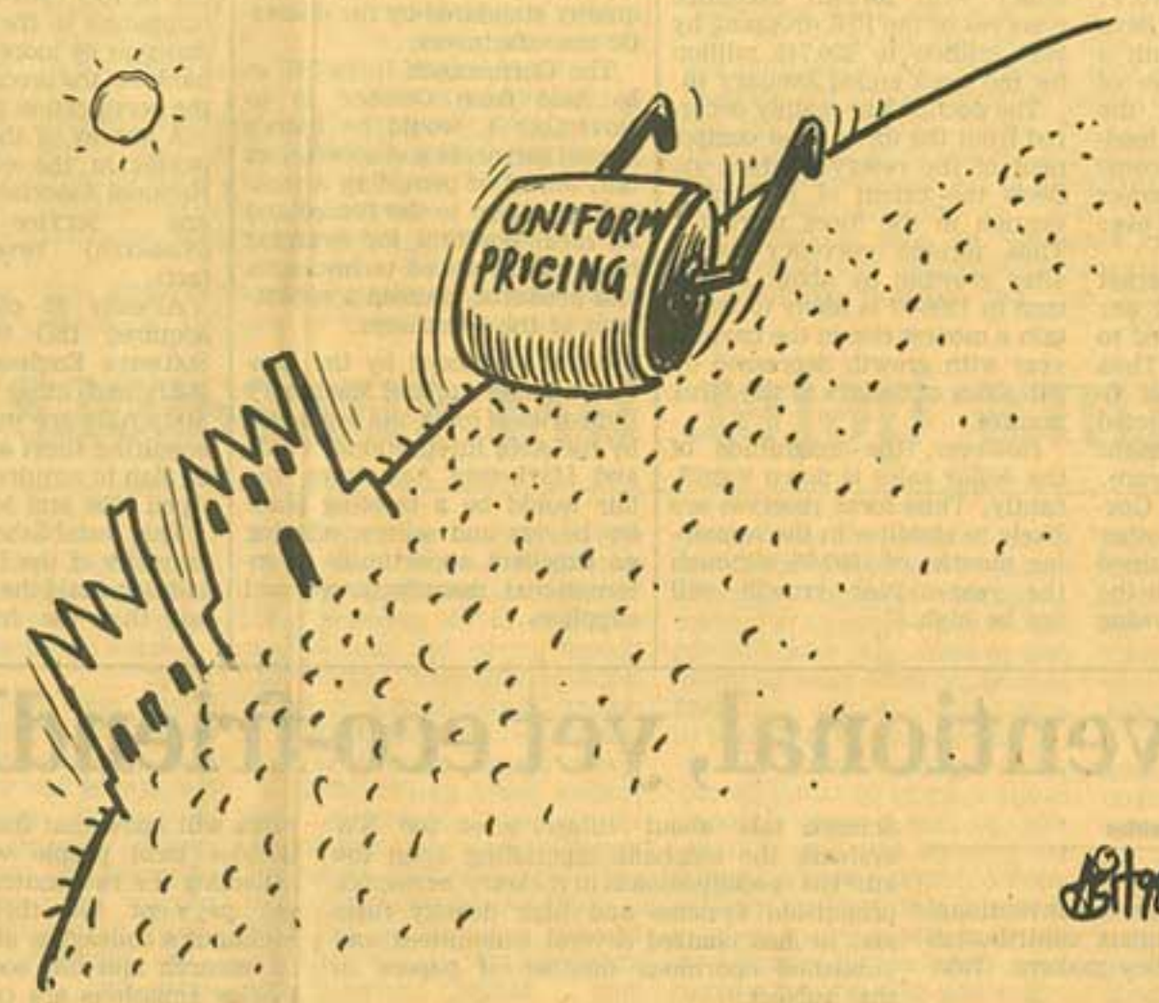
Needed a level playing field

Without a level playing field, introduction of uniform pricing will lead to closure of many plants, says **Uttam Gupta**



IN the context of giving shape to a new pricing policy regime for fertilisers in place of the existing dispensation, i e retention pricing scheme (RPS), various alternatives are being talked of. Prominent amongst these include uniform administered pricing, group pricing, import parity pricing and pricing based on free market etc. While these may vary in details, all are common in one respect.

Unlike RPS, which provides for a fair ex-factory price to each unit to cover its reasonable cost of production, including a margin of profit — currently at 12 per cent post-tax on net worth — any of the above-mentioned alternatives is expected to throw up a uniform number for all units or a group of units. Units producing at cost higher than this will lose, whereas units with lower cost will gain. While the system rewards the latter, the former will be under pressure to reduce cost in order to remain viable. That is what competition is all about, and some of us find merit in uniform pricing for the same reason.

There is a serious danger in this approach, as apart from efficiency in operations — capacity utilisation, energy use etc — cost of production depends largely on cost of purchased inputs including feedstock/fuel, utilities, e g power, water and services, railways over which manufacturers have no control. In fact, these are largely controlled by the government.

The units when set up — majority of them before 1991 — did not even have a choice as to which feedstock to use, where to locate the plant and what should be the technology. Virtually, all relevant parameters were decided by the government. For most of the units set up after 1991, decisions were taken under the controlled regime.

Even projects on which decisions have been taken in the liberalisation era — post-1991 — choices have been seriously constrained as feedstock/fuel supplies are mostly from government-owned and controlled undertakings and all vital decisions concerning feedstock linkage continue to be taken by the government.

Thus, even if plants operate at the optimum level, substantial variation in production cost could arise, depending on feedstock used and location of the plant. Let us first consider the impact of differences in feedstock. Compare a naphtha-based plant with the one based on gas, both located in, say, Uttar Pradesh.

The current ex-refinery price of naphtha is Rs 7624 per tonne. Including excise duty (nil), freight and sales tax, its cost at factory gate works out to about Rs 8500 per tonne or Rs 850 per m kcal (1 tonne 10 m kcal). For gas, corresponding to basic price of Rs 2411 per thousand cubic metre at landfall point and after including royalty, CST and transport charge, cost at factory tap is about Rs 3650 per thousand cubic metre or Rs 430 per m kcal (1 cubic metre 8500 kcal).

Let us take energy use for the gas-based plant to be about 6 m kcal per tonne urea. Naphtha being an inferior feedstock, its energy efficiency is about 10 per cent more or 6.5 m kcal. With these and delivered cost of energy as above, production cost of the plant on naphtha will be about Rs 5525 per tonne as against much lower cost of the gas-based unit at Rs 2580 per tonne.

To capture the impact of location, let us compare the gas-based plant in UP/Rajasthan — fed by HBJ pipeline — with another gas-based unit located at landfall point (Gujarat). The delivered cost of gas to the latter is about Rs 2670 per thousand cubic metre or Rs 297 per m kcal (1 cubic metre 9000 k cal) as against Rs 430 per m kcal to the former. The difference arises mainly due to transport charge of Rs 1150 per thousand cubic metre or Rs 135 per m kcal (1 cubic metre 8500 kcal) paid by plants along HBJ. Purely on this account thus, production cost of plant along HBJ is more by about Rs 800 per tonne (133 x 6).

Amongst plants based on naphtha also, wide variations occur on account of location. The cost of naphtha delivered at factory gate is about Rs 8200 per tonne at MFL, Manali (TN), Rs 8500 per tonne at SFC, Kota (Rajasthan), Rs 9300 per tonne at ZACL Goa and Rs 9500 per tonne at IFFCO-Kalol (Gujarat). Apart from freight, these are mainly due to differences in sales tax, i e three per cent in Tamil Nadu, 17 per cent in Goa, 20 per cent in Gujarat etc.

The vintage of the plant also contributes to huge variation in cost. A new unit has higher investment cost due to inflation, rupee depreciation and attendant higher burden of taxes and duties. For instance, units commissioned recently, i e 1994-95, along HBJ have investment cost almost double that of similar plants — same feedstock, size and technology, — set up in late 80s. This leads to much higher production cost of the former, i e about Rs 2000-2500 per tonne.

Ignoring these differences in cost — beyond control of individual units — forcing a common price on all or a group will lead to serious distortions. Much will depend on what level price is set. To illustrate, let us take two units A and B with cost x and y, y being more than x. At x, B will be unviable even as there is saving in subsidy (y−x). If price is set mid-way between x and y, B will still be unviable and no saving in subsidy. In a third scenario, if price is fixed at y to make B viable, A would reap bonanza (y−x) at the cost of the exchequer.

While contemplating a new system, the government is guided primarily by the need to reduce subsidy. In view of this, it is unlikely to consider the second and third alternative as these would leave subsidy unchanged as in the former or increase as in the latter. It may settle for the first — indeed, high-powered B B Singh Committee, in mid-80s, recommended uniform pricing on the basis of least cost units — which saves on subsidy.

This would, however, lead to virtual closure of B and resultant loss of production having to be made up by imports which could be much more costly and entail higher subsidy outgo. Additionally, this would entail avoidable increase in foreign exchange outgo, besides further straining the limited/inadequate infrastructure at ports and internal transportation of material to consumption points.

Before, the high-powered Hanumantha Rao Committee ventures into recommending a system that involves price fixation/setting on a uniform basis, it needs to assess whether it would be possible to put various plants on a common footing in regard to cost of feedstock delivered at plant site on the one hand, and capital cost on the other. Without necessary measures to create a level playing field in respect of these two major determinants of cost, introduction of uniform pricing will only lead to closure of a large number of plants and discourage fresh investment. Such a step will not only be highly unfair and discriminatory, but also, contrary to national economic interest.