

No sign yet of urea decontrol

A hike in the urea price to reflect the increase in cost is fundamental to fertiliser reforms. But, being a politically-sensitive issue, it has received scant attention. The new urea policy also ignores the nexus between the high feedstock cost and high urea production cost. It is thus most unlikely that the conditions for a smooth transition to decontrol of the urea price will be created, says Uttam Gupta.

IN THE 2001-02 Budget, the Government had made three important announcements in regard to the fertiliser policy. These were:

- Implementation of the ERC (Expenditure Reforms Commission) recommendation for phased deregulation of urea.

- Replacement of the existing unit-wise retention-pricing scheme (RPS) by a uniform group-based concession scheme.

- Linking concession on plants using naphtha, fuel oil and LSHS (low-sulphur-heavy-stock) to their respective import parity prices.

The ERC (2000) had recommended an increase in the selling price of urea by 7 per cent per annum beginning 2001 so as to reach its anticipated import parity price (IMPP) level of Rs 7,000 per tonne in the 2006. It also recommended that on purchases of up to 80 kg, the farmers should be exempt from the price rise.

In order to ensure that complete decontrol of the urea price is achieved by 2006 without any major dislocation, it was necessary that the Government strictly followed the ERC recommendation. Unfortunately, it has not. We are in the third year of ERC time frame and the price continues to languish at Rs 4,830 per tonne. Even assuming that in the remaining three years, the price is increased by 7 per cent per annum (seems unlikely), the resultant price level of Rs 5,900 per tonne would still be much short of the target.

A suitable increase in the selling price of urea to at least partially reflect the rise in cost has been the most fundamental element of reforms in the fertiliser sector. However, being the most sensitive area from a political standpoint, it has received scant attention. Even the Group of Ministers (GOM) under the chairmanship of Mr K. C. Pant, Deputy Chairman, Planning Commission, which made far-reaching recommendations in regard to new pricing policy for urea, refrained from

commenting on the selling price, much less endorsing the ERC recommendation.

As regards the second announcement on replacement of the unit-wise RPS by group-based concession scheme, the ERC had recommended adoption of 'S' concession rates for 'S' different groups — pre-1992 gas, post-1992 gas, naphtha, fuel oil/LSHS and mixed feed (involving usage of naphtha / fuel oil up to 25 per cent by a gas-based plant). The concession under each group was to be worked out by taking a weighted average of the retention prices of all the plants, as determined under existing dispensation of RPS (by using a combination of actual or norms for various cost components).

Under the RPS, these costs were being compensated on a unit-specific basis. In other words, each unit got a price as per its own assessed cost. Now, when the weighted average is given to all the plants, plants whose cost is higher than the average lose out, while others whose cost is lower will gain. Under the above scheme of

averaging, the fortunes of individual plants depend on how the groups are constituted and the placement of plants in any given group. To gauge the importance of this, let us look at the following scenario.

Group I consists of all low cost plants and Group II includes all high cost plants. A plant in Group II has a retention price lower than the group average. It stands to gain if it stays in this group. But, if it is shifted to Group I, it will lose. This is because its retention price will be higher than the weighted average of all plants in that group. Since the issue could not be resolved at the bureaucratic level, the Government gave the mandate to the GOM headed by Mr Pant.

The Pant panel was the obvious choice as it had earlier undertaken a comprehensive examination of the RPS for finalising its recommendations on the changes in the policy parameters for the Seventh and the Eighth pricing periods — July 1, 1997 to March 31, 2000 and April 1, 2000 to March 31, 2003 respectively.

Based on the recommendations of the GOM, the Government announced the new pricing scheme (NPS) for urea manufacturers on January 30, 2003. Under the NPS, all plants were constituted into '6' groups instead of the '5' recommended by the ERC.

While the naphtha group in the ERC package was broken into two groups by using 1992 as the cut off year, the remaining groups were retained as such.

The January 2003 notification is an intricate document and requires separate discussion for a meaningful as-

essment of the implications for various stakeholders. But the moot point to note here is that the NPS is applicable only for the period up to March 31, 2006.

The notification states that the policy for the period beyond March 31, 2006 will be decided after reviewing the implementation of the NPS in Stage I (April 1, 2003 to March 31, 2004) and Stage II (April 1, 2004 to March 31, 2006). In view of this, there is uncertainty on the policy for the period beyond March 31, 2006.

The ERC had proposed a '4'-stage restructuring of its Group Concession Scheme, leading to a situation of one concession — in Stage IV — being only for plants based on LNG, including existing naphtha-based plants, switching over to use of LNG. In this Stage, the industry was expected to face full decontrol. In sharp contrast, the NPS does not go beyond giving concessions to plants in six different groups.

The NPS applies only to the existing urea manufacturing units. The new urea projects and substantial expansion/revamp of the existing projects need to be covered by a separate policy framework. Until this policy is announced, fresh investment will be dogged by uncertainty.

The proposal of linking the prices of naphtha, fuel oil / LSHS to their respective IMPP (for determining the concession) was meant to reduce subsidy payments. This was based on the implicit assumption by ERC that the domestic oil companies were overcharging and that, by pegging concession to IMPP, they would be forced to reduce prices. The Government even followed this up by putting in place the required administrative arrangements. Indeed, from July, 2001, under directions from the Ministry of Petroleum and Natural Gas (MPNG), the oil PSUs were fixing the prices of naphtha, fuel oil and LSHS as per a formula hammered out at the inter-ministerial level.

From April 1, 2002 however, the MPNG allowed the oil companies to fix prices on their own. It argued that after dismantling the APM, it had no role to play. This argument is flawed, as naphtha, fuel oil and LSHS were decontrolled in April 1998. The crux of the matter is that in the euphoria over dismantling the APM, the Government simply forgot about the overriding need to rein in the prices of feedstock and fuel for the fertiliser industry and, in turn, the subsidy payments. Meanwhile, using their monopoly position,

the oil companies have been merrily charging high prices for the feedstock.

In regard to natural gas, a GOM (headed by Mr Pant) recommended an increase in its price from existing Rs 2,850 per thousand cubic metres to Rs 3,200 per thousand cubic metres. The MPNG, on its part, is pressing for complete deregulation of the gas price. If, implemented this would result in a steep increase of almost 100 per cent. This will push up the production cost of urea and, in turn, subsidy.

Having reviewed the developments since the submission of the ERC report and Finance Minister's Budget Speech shortly thereafter, let us now turn our attention to what the ERC wished and whether we are on our way to achieving the goal set by it. Apprehending the serious consequences of immediate decontrol, the ERC had fixed a time-frame of five years for achieving this.

During the transition, the ERC wanted all stakeholders to prepare for D-day so that the switchover could be smooth. It wanted farmers (except subsistence farmers, for whom it prescribed a special dispensation) to get gradually adjusted to a price close to the IMPP of urea. It wanted producers to take measures to eventually align their production cost to the IMPP. And it wanted the Government to withdraw subsidy in a manner that it does not leave the farmers and industry high and dry.

As we look back, progress on all the fronts has been tardy, to say the least. The price paid by the farmer is nowhere near the IMPP. The production cost of domestic urea continues to remain high thanks to the continued high prices of feedstock and fuel.

Ironically, the new urea policy only harps on efficiency of energy use and does not deal with the nexus between the high feedstock cost, on the one hand, and high urea production cost, on the other. No one seems to be bothered about the cascading effect of taxes and duties on the cost of various raw materials, including feedstock. Under these continuing circumstances, it is most unlikely that the conditions for a smooth transition to decontrol of the urea price would ever be created. We may not see urea decontrol in the foreseeable future. The reforms in the fertiliser sector will continue to remain elusive.

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