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Pricing of hydrocarbon feedstock — I

Need for a consensual approach

Unlike other commodities, the marketing and distribution of farm products cannot be organised according to the dictates of the market forces. Though the Government's farm subsidies have resulted in the country's present comfortable position in the foodgrains sector, the higher cost of fertilisers, consequent to the recent substantial hike in the price of hydrocarbon feedstocks, continues to be a matter of grave concern, says **Uttam Gupta.**

OF LATE, even the oil and petroleum sector which was, until now, under a totally controlled regime, has been affected by liberalisation. Recently, a Committee constituted by the Ministry of Petroleum and Natural Gas on restructuring the hydro-carbon sector has recommended, among others, deregulation of prices of various petroleum products which were all along covered by the administered pricing scheme.

It may well be some time before the Government takes a decision on this recommendation. But the moot point is that the prices of various hydro-carbon feedstocks have already been raised substantially with consequential adverse effect on the user industries. Among the user industries, fertilisers is the one which gets most seriously affected. This is because of certain intrinsic and inevitable disadvantages it suffers.

Hydro-carbon feedstocks, that is naphtha, fuel oil, LSHS, etc., constitute essential raw-materials and are the source of energy in the manufacture of fertilisers. Consequently, the cost of fertiliser production is heavily dependent on the pricing of these feedstocks. Fertiliser being an essential input in the production of foodgrains and other agricultural commodities, it is not an easy task to pass on the resultant higher cost, caused by the increase in feedstock prices, to the farmers by way of increase in the selling prices.

A majority of the farmers are small and marginal (about 75 per cent of total farm households) who cannot afford high cost fertilisers and are bound to resist steep increases. Even for the so-called better-off farmers, who produce marketable surplus and therefore may be in a position to pay more for the inputs, including fertilisers, the resultant higher cost of production of foodgrains will act as a major deterrent. This is because the output has to be sold to the majority of the poor foodgrain consumers, whether they buy it from the ration shop or from the free market. Unlike many other commodities, the marketing and distribution of foodgrains and other essential agricultural items cannot be organised purely in terms of the dictate of the market forces. A concept that only those who can afford need only be fed is something that can never work and is, in fact, anti-thetical to the very foundations of a democratic society.

Recognising these unique features and, in particular, the inevitable link between high-cost modern technology input, such as fertilisers, on the one hand and the poor on the other, the Government has all along immunised the selling price of fertilisers from the increasing cost. This was achieved by controlling the selling price at a lower level and reimbursing the excess of reasonable cost of production and distribution over this as subsidy to the producers. The subsidy was, indeed, acting as a buffer. But for this, we would not have seen the rapid advance towards the goal of achieving self-sufficiency in foodgrains production and the resultant food security that we are so much proud of now.

About two-and-a-half years ago, phosphatic fertilisers were decontrolled and, along with that, the pricing and subsidy scheme abolished. These changes may have been necessitated by the requirements of the overall fiscal stabilisation programme.

However, the underlying fundamentals have not changed. Higher prices of feedstock and, consequently, higher cost of fertilisers continue to be a matter of grave concern. This is amply vindicated by a substantial decline in the consumption of phosphatic fertilisers after the decontrol and the resultant higher prices. In the case of urea, the impact is not felt because it is still subsidised under the administered pricing scheme.

With regard to hydrocarbon feedstocks pricing, the Government has evolved a special dispensation in as much as the supplies for use in the manufacture of fertilisers were charged a lower price compared to the price charged to other industries. For instance, in early 1990, the ex-refinery price for naphtha supplied to the fertiliser units was Rs. 1,982/tonne as against Rs. 3,211/tonne for non-fertiliser use. This was very much in line with the conscious policy of the Government to facilitate lower cost of production and, in turn, keep the fertiliser subsidy burden within manageable limits.

During the early nineties, this fundamental consideration was completely ignored as systematic and the substantial increase in the administered prices has not spared even fertilisers. First, it was the Gulf surcharge introduced in October 1990 which was followed by another round of increase in July 1991 and then again, in September 1992, when the basic price of naphtha was further increased by a hefty 36 per cent and that of fuel oil and LSHS by 54 per cent each. In a short span of just about four years, the ex-refinery price of naphtha was increased from Rs. 1,982/tonne to Rs. 3,723/tonne, that is, almost 100 per cent. The increases in September 1992 were even contrary to the JPC recommendation according to which the prices of these feedstocks should have been frozen at the then existing levels.

The Ministry of Petroleum and Natural Gas also invented a novel method to slap further hike in feedstock prices to the fertiliser units. The process of fertiliser manufacture involves the utilisation of hydrocarbon feedstocks as feed (for supplying hydrogen) and fuel which is essentially meant for firing the boilers and for steam generation. On an average, the ratio is two-third for the former and one-third for the latter, although the actuals may vary depending on individual plant configurations and process technology.

The oil companies sought to charge a non-concessional rate from September 9, 1992, for all the feedstock in respect of supplies for firing the boilers and for steam generation facilities.

In the case of naphtha, this amounts to an increase in the basic price (including excise duty but excluding sales-tax and transportation cases) from Rs. 2,732.02/tonne to Rs. 7,698.63/tonne, that is, a whopping increase of Rs. 4,966.62/tonne. In contrast, the price applicable on the supplies as feed was Rs. 3,728.12/tonne which was Rs. 996.1/tonne higher than the level prevailing prior to September 1992.

But for the withdrawal of the concession of supplies as fuel, the cost push effect to the industry would have been restricted to the general increase of only Rs. 996.1/tonne. Following the decision, however, the effective increase in the price of naphtha would work out to Rs. 2,306.4/tonne (996.1 x 0.67 + 4,966.62 x 0.33). In turn, this would have meant a steep increase in the cost of production of urea by about Rs. 1,400/tonne and that of DAP by about Rs. 500/tonne.

As the serious ramifications of the withdrawal of the concessional rate for non-feed purposes became apparent, the decision was withdrawn in a 'subtle manner'. There was no clear-cut notification restoring the concession even as the fertiliser companies continued to be billed by oil corporations at the revised prices and some of them were even threatened with cut off in supplies for non-payment at the enhanced rates. These threats may not have materialised, but, the Democles' sword still hangs.

The Ministry of Petroleum and Natural Gas has stuck with its decision to charge the supply of NGL (natural gas liquid) to M/s Kribhco on the basis of the non-concessional rate applicable in respect of the supplies for non-fertiliser use. This would mean a steep increase in the basic price of NGL by about 63 per cent, that is, from Rs. 3,722.78/tonne to Rs. 6,075.69/tonne. After including excise duty and sales-tax, landed cost of Kribhco is still higher by about 81 per cent, that is, from Rs. 4,388.25 charged earlier to Rs. 7,861.78/tonne.

NGL is being used by Kribhco for firing its boilers and steam generation following the unilateral and arbitrary decision of the ONGC to deny the supply of gas since 1993 in total violation of the contractual commitment.

As it is, the switch over from gas to NGL has led to a significant increase in Kribhco's cost of production by about Rs. 45 crores per annum due to differentials in the price of gas and NGL. The recent decision to raise the price of the latter would cause a further increase in the annual expenditure by about Rs. 70 crores.

The technique employed on naphtha, fuel oil and LSHS in September 1992, is now being tried on NGL with the only difference being the relevant directive of the Ministry to the oil companies categorically states the reason, "NGL is used as fuel and not as feedstock".

Clearly, the attempt is to test the waters and if this subtle move passes muster, then this would pave the way for launching the much-bigger offensive to cover all hydrocarbon feedstocks. In that event, almost the entire fertiliser industry (barring the few coal-based plants) will get seriously affected.

In respect of gas-based plants, it may be mentioned that the decision of ONGC/GAIL to deny supplies for firing boilers and for steam generation is not merely restricted to Kribhco but, in fact, applies to all gas-based units, including those along the HBJ pipeline. Already, they are burdened with additional costs on account of replacement of gas by substitute fuels. Withdrawal of concessional supplies would make things much worse.

(To be concluded)

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