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Raw deal for the fertiliser industry

There is a need for bringing down the cost of feedstock, especially naphtha and fuel oil, says **Uttam Gupta**

FERTILISER industry in India has a vital role in supplying essential plant nutrients needed for increasing foodgrain production to feed the growing population at acceptable levels of nutritional standards. Although the government has, time and again, vowed to ensure its continued health and growth, various steps implemented in recent times militate against this objective.

Only about 14 months back, the industry got a severe jolt when w e f July 3 1996, prices of various hydrocarbon feedstocks used in production of urea and complex phosphatic fertilisers, i e naphtha, fuel oil (FO) and LSHS, were raised by hefty 30 per cent each. Even before, it could fully recover from this, yet another blow has been struck.

The government has taken a decision, in principle, to abolish concession in price on supplies to fertiliser industry and fix a uniform price based on the concept of import parity pricing (IMPP). Linkage to IMPP means that ex-refinery price for domestic supplies should be fixed on FOB price in the world market. Indeed, this is what suppliers from abroad realise from exporting naphtha/FO and Indian refineries too would fetch the same on their exports.

This principle has been thrown to winds as naphtha price at Rs 7624 per tonne is on the basis of C&F landed cost plus port handling charges as against about Rs 5800 per tonne if the price had been fixed on FOB basis. The manufacturer, thus, lands up paying Rs 1800 per tonne more ex-refinery and even higher on delivered basis due to cascading effect of sales tax.

In case of FO, distortion is even greater as price at Rs 5508 per tonne includes customs duty, i e 30+2 per cent as well. This is despite the fact that duty on import of FO for use in fertiliser manufacture is nil. Direct import by fertiliser manufacturers would be cheaper by about Rs 1400 per tonne, but they cannot as import of FO is canalised through IOC.

This has catapulted Indian fertiliser industry to a situation whereby bare energy cost exceeds the return from selling urea at controlled price by a substantial margin. For a typical naphtha-based plant using FO for offsite facilities, former is about Rs 6800 per tonne whereas the latter is only Rs 3520 per tonne — corresponding to selling price of Rs 3660 per tonne (differential of Rs 140 per tonne being towards distribution margin).

The government may argue that so long as it controls prices to farmers at a level they can afford and, at the same time, gives a fair ex-factory price to manufacturer (common known as retention price) covering his reasonable cost of production — this includes energy cost, other variable cost, for example power, water, bagging etc, capital related charges (CRC) and other fixed costs — there should be no problem.

No doubt, it can take care of both, i e farmers and industry, but by providing subsidy support. So, there is a cost associated with it. Needless to say, that fertiliser subsidy has been rising in geometric proportions. During 1996-97, on urea alone, this was Rs 6093 crore. During 1997-98, budget provision is Rs 7190 crore, which is likely to increase by about Rs 1000 crore due to recent steep increase in feedstock prices.

The irony is that even subsidy is under attack. The high-powered Hanumantha Rao committee on review of fertiliser pricing policy (HPC) — set up in January 1997 — has been mandated to recommend an alternative to present dispensation which prunes subsidy without affecting the health and growth of the industry and, at the same time, keeps farmers happy. How the committee would perform such a feat remains to be seen! However, suggestions made in a background paper for a seminar held recently under the auspices of HPC, have raised alarm bells.

A package for phased deregulation has been offered. This involves in the first step replacement of RPS by uniform administered price; gradual increase in selling price in the second step and urea decontrol accompanied by decanalisation of imports in the third.

Under uniform pricing, all 34 urea producing units will get a single ex-factory price — against unit specific RP under RPS. This could be a weighted average of reasonable production costs of all plants or majority of least-cost plants, latter recommended by high-powered B B Singh committee in mid-1980s.

Whichever basis is adopted, the high cost naphtha/fuel oil based plants will become unviable. The newly set-up gas based plants too will meet the same fate primarily in view of high capital cost. Fixing price at a higher level to protect their viability is theoretical as this would inflate overall subsidy bill.

As an alternative, uniform pricing on IMPP basis would set still lower benchmark due to lower cost of imported urea especially in view of cheap gas available to plants in exporting countries. For instance, expressed in US$ per million Btu, gas price is 1.0 in Iran, Indonesia, Bangladesh, Russia, 0.77 in Oman, 0.50 in Saudi Arabia, etc. Against these, price in India is 2.15 for plants located on-shore and 3.1 to HBJ plants. Thus, even old depreciated gas-based plants could also be threatened.

The feedstock prices are set to increase further in the years to come. The price of naphtha/fuel oil, having already been linked to IMPP, is bound to go up automatically due to rupee depreciation alone; increase in dollar price — quite likely in view of projected huge import demand — especially for naphtha, will compound the effect.

The gas price too is slated to increase to US $2.8 per million Btu for onshore plants and US $3.7 per million Btu for HBJ plants by 1999-2000. Thereafter, it will go up still further even as the government seeks to link it to 100 per cent of price of international basket of fuel oil.

Contrary to the impression — conveyed in the background paper — that phasing of change over to new system would give domestic manufacturers time to gear themselves for absorbing the shock, the situation will be much more serious after, say, three years than it is now.

In view of the feedstock prices rising continuously leading to increase of production cost, and selling price of fertiliser not being raised in tandem, the goal of subsidy elimination could be achieved by making the industry unviable.

The government should take note of danger signals without further loss of time and prevent the situation from assuming catastrophic dimensions. There is an urgent need for bringing down the cost of feedstock especially naphtha and fuel oil, to realistic levels and establish parity with the price of gas. At the same time, there is need to increase selling price at least to level and reflects international energy cost plus reasonable coverage towards fixed cost including CRC. Without these essentials in place, any move to implement the package recommended in the background paper, will spell doom for the fertiliser industry, unprecedented loss of domestic supplies and heavy dependence on imports.