

Concession scheme for phosphatic fertilisers

Turning clock back to pre-reform era

The new policy for complex fertilisers is tantamount to encouraging high-cost production by plants in one group while penalising low-cost producers in another. This is quite contrary to the spirit of reforms and militates against the overriding objective of making the industry cost-competitive, says Uttam Gupta.

BASED on the recommendation of the Joint Parliamentary Committee on Fertiliser Pricing (JPC), the Government had removed pricing and distribution controls on all phosphate and potash fertilisers from August 25, 1992. Concurrently, the unit-wise Retention Price Scheme (RPS) covering phosphate fertilisers was withdrawn.

At the time, one had thought the era of subsidies had come to an end. However, in less than a month of decontrol, the Government resurrected subsidy on all P and K fertilisers under a new avatar — a concession from October 1, 1992. In lieu of this, State governments controlled the selling prices during the initial years.

Despite revival of controls through the backdoor, the new dispensation represented a substantial improvement over the erstwhile RPS. Unlike the latter, which was unit-specific, the former provided for a uniform concession to all manufacturers. The scheme also provided for payment of concession on actual sale, unlike the RPS, providing for payment on dispatch.

Until 1996-97, the concession rate was fixed in an ad hoc and arbitrary manner. From 1997-98, when the Government started fixing the selling price as well, an Empowered Committee (consisting of representatives from the Ministries concerned and the industry) determined production and distribution costs and, in turn, the concession.

Meanwhile, the Bureau of Industrial Costs and Prices (BICP) — earlier incarnation of the Tariff Commission — was entrusted to conduct a detailed costing study of the phosphate industry. Based on the recommendations of the BICP, an Inter-Ministerial Group (IMG) approved a methodology for determination of the concession. This method, in use since 1998-99, is briefly described as under.

The raw material component of DAP cost was determined by applying the consumption norms of phosphoric acid and ammonia to their respective C&F cost. The other cost components — capital-related charges (CRC), conversion cost, marketing and selling expenses, etc., were taken at a uniform level as per the data for 1997-98.

In order to suitably capture fluctuations in the cost of raw materials, the concession was fixed on a quarterly basis. Thus, for any quarter, this was determined by using C&F cost of phos acid and ammonia in the previous quarter and the exchange rate for the relevant quarter. Increases/decreases in rail freight were, however, adjusted on an annual basis.

The cost of production and distribution — as determined above — minus the selling price (also fixed by the Government) gives the concession for domestic DAP. The concession on other complex fertilisers was determined on

a proportionate nutrient basis to the concession on domestic DAP in the following manner.

Let us assume the concession on domestic DAP is X. In step 1, X is divided by 640, being the sum of N and P nutrients in DAP (180 kg N and 460 kg P). The resultant number — say, Y — is multiplied by sum of nutrients in the relevant complex fertiliser e.g., 560 in case of 28:28:0 (generally used by farmers in the southern States). The concession on this product will, therefore, be 560Y.

With pre-fixed norms (for instance, 0.469 tonne of phos acid for a tonne of DAP), manufacturers had an incentive to increase efficiency in operations in order to improve the profitability. They also had the flexibility to choose the best process route and operating practices for optimising production cost.

Despite the uncertainties generated by sudden decontrol, the scheme helped sustain growth of the domestic phosphate industry during the 1990s. An important feature of growth during the decade was the setting up of new grassroots plants for production of DAP/complexes using domestically manufactured phos acid.

The cost of phos acid produced in India is lower than that of imported phos acid. This is because the suppliers' cartel in the international market invariably maintains the price of phos acid at a disproportionately higher level than justified by its production cost.

It, therefore, makes economic sense to import basic raw materials, such as rock phosphate and sulphur, and produce phos acid in India.

During the last five years or so, the share of DAP capacity based on captive phosphoric acid has increased from a little over 10 per cent to about a third currently. This, in turn, has forced global suppliers of phos acid to reduce its price from \$432 per tonne to about \$350 per tonne. As a result, the Government has saved enormously in subsidy payments besides saving in foreign exchange.

For other complex fertilisers, adoption of a uniform industry approach in fixing concession (linked to concession on domestic DAP) incentivised manufacturers to optimise production costs. Some manufacturers even disbanded their naphtha-based, high-cost ammonia plants and put up facilities for procuring cheaper imported ammonia.

Whenever, there is a success story, certain forces emerge that tend to disturb the apple cart. This is precisely what has happened to the phosphate sector in recent times. For reasons not quite brought out explicitly, the Government directed the Tariff Commission to conduct fresh and separate studies for DAP and other complex fertilisers.

For complex fertilisers, the Tariff Commission recommended adoption of

the production-cost approach instead of linking concession on these to that on DAP. It recommended separate concessions for (i) plants based on imported ammonia and those using ammonia made from gas and (ii) plants using ammonia based on naphtha and fuel oil.

Under the above package, plants in group (ii) got a substantially higher concession, primarily to compensate for the much higher cost of ammonia made from naphtha and fuel oil. The Government implemented the Commission's recommendations from April 1, 2002 after carrying out some modifications.

The modifications were meant ostensibly to rein in overall subsidy outgo.

mind-set. Thus, it recommended separate concession for (i) plants based on captive phosphoric acid and (ii) plants based on imported phosphoric acid. The concession for plants in Group (i) is significantly lower than the concession for Group (ii).

As for complex fertilisers, for DAP also, the Tariff Commission has followed the production approach. Using the actual cost data, it works out the normative cost for each unit in the group and then computes a weighted average (WA) of all these normative costs.

The WA minus the selling price is the concession for the relevant group. While deciding on the norms for ca-

also, the Tariff Commission has used unrealistic numbers in computations. For instance, the C&F cost of phosphoric acid is taken as \$312 per tonne for February 2002, as against the much higher weighted average price of \$334 per tonne for that month. The position for ammonia is broadly similar.

The usage of norms that are not capable of being achieved on a sustained basis (for some plants, these are almost impossible to achieve) has resulted in a steep reduction in concession rate over the level allowed under the existing method. If implemented, these could make majority of the plants unviable.

A close look at the Tariff Commission's computations reveals that costs of two new plants in Group (i) have been worked out using the LRMC (Long Run Marginal Cost) principle. Under this principle, capital-related charges are distributed over the entire life of the project. This could lead to an unprecedented shortfall in generation of funds vis-à-vis loan repayment obligations and may even result in immediate closure of these plants.

As brought out earlier, the country has benefited enormously from setting up of plants based on captive phos acid (read group (i) plants) by way of saving in foreign exchange as well as subsidy payments. These gains will come to a naught if the Tariff Commission recommendation is implemented.

In view of above, while the Tariff Commission prescription has a debilitating effect on almost all the plants across the board, it virtually cripples the plants based on captive phos acid. As for complex fertilisers, the discrimination against the low-cost producers is evident in the case of DAP as well.

After spending more than a decade under uniform pricing, the present moves will only push us back to the days reminiscent of unit-specific cost plus RPS. These are retrograde steps and must be avoided or else the industry will never be able to face the rigours of the impending WTO compatible liberalised regime.

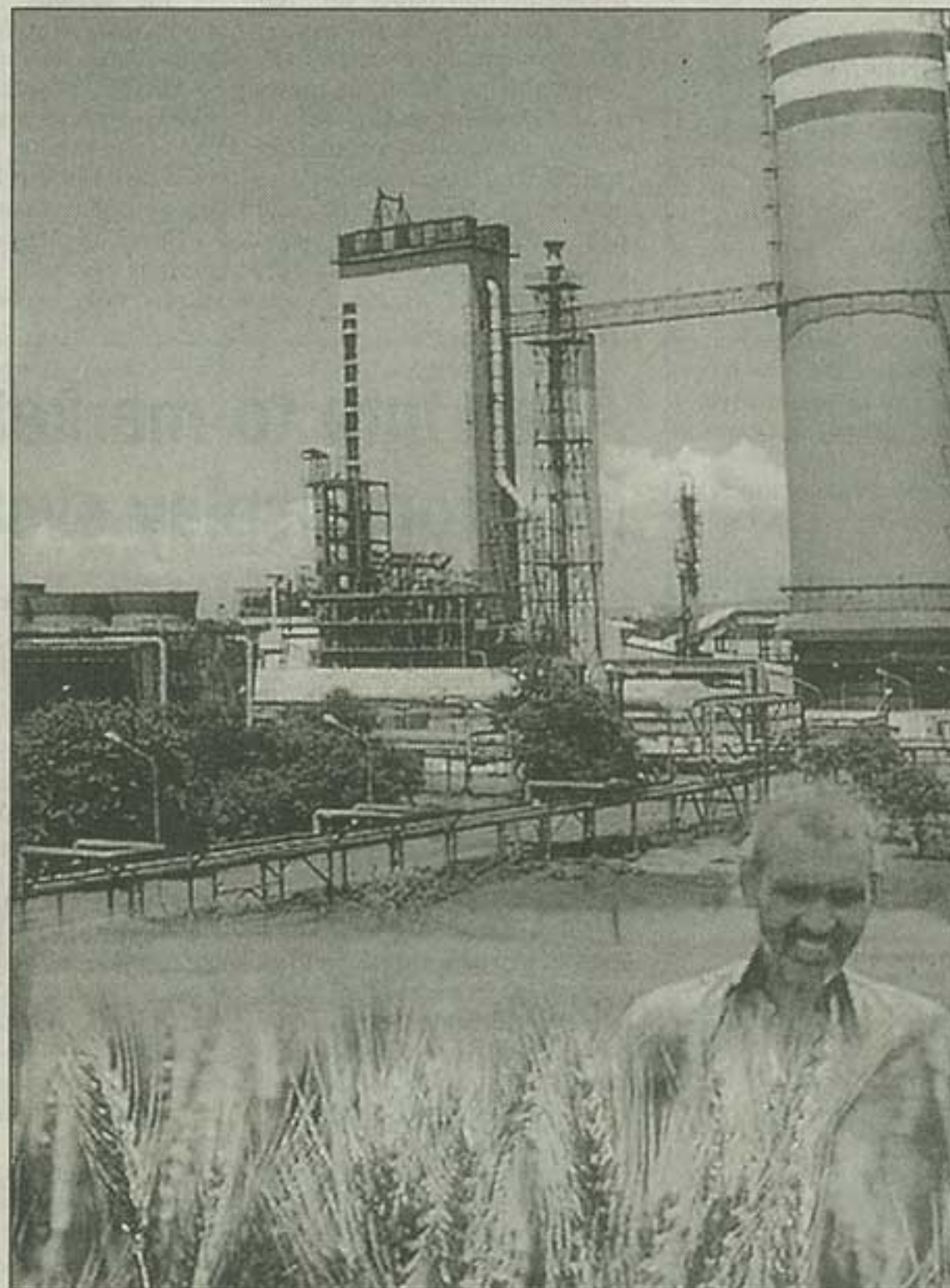
The Government should refrain from implementing the Tariff Commission recommendations for DAP. Instead, it should consider switching over to pricing based on the principle of import parity (IMPP).

In other words, all manufacturers should get a uniform concession equal to the difference between the IMPP and the selling price.

Since, at present, import duty on DAP is 5 per cent (this being the bound rate under WTO), the domestic industry may be given additional concession to offset its handicap due to high cost of imported raw materials. As and when the Government manages to get the bound rate raised to a reasonable level of, say, 25-30 per cent, this may be withdrawn.

For other complex fertilisers, the Government should revert to the earlier dispensation of linking the concession on these fertilisers to that on domestic DAP. Needless to say, all manufacturers of any product should get concessions at a uniform rate.

(The author, an economist, is an expert on fertiliser policy. Feedback may be sent to uttamgupta2003@yahoo.co.in)



Thus, certain costs, such as investment in handling facilities for imported ammonia or higher cost of N supplied from imported urea, or cost of incorporating sulphur in certain complexes, were disallowed. These disallowances affected largely the plants in group (i), which also happen to be the low-cost producers.

The new policy for complex fertilisers is tantamount to encouraging high-cost production by plants in group (ii) while at the same time penalising low-cost producers in group (i). This is totally contrary to the spirit of reforms and militates against the overriding objective of making the industry cost-competitive.

In the case of DAP also, the Tariff Commission was governed by the same

capacity, capacity utilisation and conversion efficiencies of raw materials, the Tariff Commission has acted in a high-handed and arbitrary manner.

For instance, production capacity (sum total of capacity norms used for individual plants) is taken as 7.4 million tonnes, against a maximum production of 5.2 million tonnes (2002-03) ever achieved by industry.

The conversion efficiency of phos acid is taken as 99.5 per cent as against an actual of 98 per cent for the majority of the plants. Significantly, the norm used by the earlier BICP was 98 per cent and there has not been any major technological breakthrough since then to warrant further tightening of the norm.

In regard to cost of raw materials