Editorial

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Uniform pricing: Putting cart before horse?

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IN a bid to reform the fertiliser sector, the 2001-2002 Budget announced replacement of the unit-wise retention price scheme (RPS) by a group-wise urea concession scheme with effect from April 1, 2001, based on the Expenditure reforms Commission (ERC) recommendation. Even as the Finance Minister, Mr Yashwant Sinha, is gearing up to present the Budget-2003, the scheme remains unimplemented.

Towards end-December 2001, the Government had promised to put into effect the uniform concession scheme within two months. The moot question is whether the Government will now be able to do what it could not over the last 11 months?

The fact is that apart from the industry, several State governments had opposed the scheme. There is an urgent need for an objective and dispassionate evaluation of the scheme.

The prime objective of a viable pricing scheme is to reward efficiency, penalise inefficiency and induce all manufacturing units to become cost-competitive in the emerging liberalised regime. At the same time, it needs to seen if it will result in significant saving in subsidy outgo. With these two major objectives in mind, a look at the ERC package.

The ERC has categorised all urea units into five broad groups: Pre-1992 gas-based plants; post-1992 gas-based; naphtha-based; fuel oil-based, and plants based on mixed feedstock. Then, it proceeds to recommend 'uniform' concession for each of these groups.

The uniform concession is determined by taking a weighted average of the retention prices of the plants under the existing dispensation of unit-wise RPS. At the outset, the retention price for any unit is the reasonable cost of production — including a margin of profit at 12 per cent on net worth — determined on the basis of prescribed norms for capacity utilisation and consumption of raw materials and utilities. Having decided as to what price a unit should be allowed, then, to turn around and say that it will be given the weighted average of the retention prices of all plants under the relevant group, is tantamount to questioning the government's decision!

Implementing the ERC package will lead to serious distortions within the industry. To understand this, consider two units — 'A' and 'B' whose retention prices are 'X' and 'Y', respectively. Let 'X' be greater than 'Y'. Under the existing dispensation, 'A' gets 'X' while, 'B' gets 'Y'. Under ERC on the other hand, both A and B will get Z which is X+Y/2. As a result, while, A loses to the extent of X-Z, B will reap a bonanza of Z-Y. The loss of A is not due to any inefficiency in operations. Likewise, B's gain is not simply because it is more efficient than A. The fact is that A is allowed a higher retention price to cover the higher delivered cost of inputs, particularly feedstock, over which it has no control. Likewise, B is allowed a lower price as it pays less for the feedstock. Had the cost of feedstock to both the units been the same, there would be no need for differential pricing in the very first place!

Ironically, by implementing the averaging concept, the Government will not save even a rupee by subsidy. This is because by paying both the units at Z, which is an average of X and Y, the total payment of subsidy will be the same as involved in paying each at X and Y, respectively. The subsidy will merely get redistributed from A to B! And yet, ERC has claimed substantial savings under its package. But, these have nothing to do with the approach to the pricing recommended by it.

The savings are primarily the result of using the import parity price (IMPP) of feedstock as against higher levels actually paid by the units. These will anyway accrue even under the existing dispensation.

In view of above, the adoption of the scheme will affect the viability of several plants despite efficient operations, and yield unintended gain for others unrelated to their efficiency. As a result, there will be substantial loss of domestic production capacity, which will force the country to import large quantities, leading to steep increase in the international price.

As a follow-up to the announcement in the 2001-02 Budget, the Department of Fertilisers is reported to have tried various groupings other than the five groups recommended by ERC.

While the aim of these exercises may be to reduce somehow the differential impact on various units, a system based on the averaging principle cannot be a viable policy option. Given the heterogeneity of the fertiliser industry, there seems to be no escape from continuing a unit-wise dispensation. The powers that be should get down to tackling the real factors contributing to inter-plant variations in production cost. Currently, on an average, the cost of gas is about $ 2.3 per million Btu; naphtha about $ 6.0 per million Btu and fuel oil about $ 5.0 per million Btu. Within each feedstock group also, the cost varies widely from plant to plant. Thus, the difference between the minimum and maximum price is $ 0.5 per million Btu in case of gas and $ 1.5 per million Btu for naphtha.

These wide variations persist despite an exercise last year at the inter-ministerial level to rationalise the prices of feedstock.

There is an urgent need for further rationalisation to put all plants at 'par' in regard to the cost of energy at the factory site irrespective of the 'source' and 'location'. Only thereafter, should the Government consider a 'uniform' pricing dispensation.

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