Editorial

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Urea: Partial decontrol defies logic

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ONE of the major recommendations of the Expenditure Reforms Commission (ERC) in its report of September 2000 was to dismantle controls on the supply and distribution of urea from April 1, 2001. Subsequently, in a note prepared by the Department of Fertilisers, the Government mooted a proposal for covering 90 per cent of the production under the Essential Commodities Act (ECA), with the remaining 10 per cent to be sold in the free market.

Reportedly, as part of the long-term policy, the Government is now planning to cover 50 per cent of the production under the ECA, leaving a balance of 50 per cent to be sold by the manufacturer in the market place. The entire production will have to be sold at the notified price, currently at Rs 4,600 per tonne. For the purpose of reimbursement, however, the latter will be paid on the basis of the retention price (RP) minus Rs 100 per tonne.

The reduction in retention price by Rs 100 per tonne for payment of subsidy on the quantities not covered by the ECA allocation is flawed. As long as the material is sold to the farmer at the notified price of Rs 4,600 per tonne, the producer has to be compensated to the 'full' extent of the excess of the reasonable production cost over this. This cardinal principle cannot be wished away simply because the Government has decided to put specified quantities outside the ambit of the ECA.

Under the retention price scheme, capital-related charges and other fixed costs are reimbursed at 90 per cent utilisation of production capacity for gas-based plants (for plants based on naphtha and fuel oil, the norm is 85 per cent). Under the new policy, this will be raised to 100 per cent by 2003-04 for plants based on gas, and 2004-05 for plants based on naphtha and fuel oil.

In view of the above, a unit can fully recover the fixed costs only if it operates the plant at 100 per cent load. Under the existing dispensation, this is assured by covering full production under the ECA. Whenever, in any given season, due to demand constraint, the Government is unable to fully accommodate the quantity, it generally allows movement of the 'uncovered' quantities. This is allocated from the opening stock in the next season.

Under the proposed dispensation, however, the Government will be under 'no obligation' to ensure off-take of 50 per cent of the production. The 'onus' of selling these quantities will clearly be on the manufacturer. Any shortfall in reaching this target will result in a corresponding under-recovery in fixed cost, including the capital-related charges. In an extreme situation of sale in the market being 'nil', the under-recovery will be 50 per cent!

Currently, the domestic supply is more or less equal to the demand at about 20 million tonnes. In view of this, why should one suspect that the units will not be able to sell their entire production at 100 per cent load? Taking advantage of the freedom of sale given in respect of the so-called balance 50 per cent, some higher-capacity units could produce and sell more, albeit at the cost of others.

It may be argued that, as subsidy payments are restricted to 100 per cent of the assessed/reassessed capacity, incremental production by such units will be uneconomical. Sounds convincing! But, this would require 'regulation' and 'monitoring' of the production meant for sale in the market place in much the same way as the quantities under ECA. This is a contradiction. How can 'freedom' and 'control' go together?

If the objective is to promote competition in the true sense of the term, the Government should implement the ERC recommendation of completely removing distribution controls on urea.

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