Editorial

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Urea concession scheme

Still no saving in subsidy

The Government has decided to replace the unit-wise retention pricing scheme for fertiliser plants by a group-based concession system. This is ostensibly to protect the viability of all efficiently run plants and maintain a reasonably high level of self-sufficiency in urea availability. But the peculiar method by which the rates have been determined will effectively result in a nil saving on subsidy, points out **Uttam Gupta.**

ANNOUNCING, in the 2001-02 Budget, the Government's decision to implement the recommendations of the Expenditure Reforms Commission (ERC), the Finance Minister, Mr Yashwant Sinha, proposed continuing the control on the maximum retail price (MRP) of urea. However, he has not accepted the ERC's recommendation for a 7 per cent increase in MRP. Thus, urea will continue to be sold at the prevailing Rs 4,600 per tonne.

There is no clear indication from the speech whether the Government will implement straightaway the ERC's recommendations to dismantle distribution controls. Perhaps, it might await completion of the proposed review of the Essential Commodities Act (ECA) 1955, particularly restrictions on the movement and distribution of essential commodities — fertilisers being one of them.

The Government has, however, decided to replace the unit-wise retention pricing scheme (RPS) by a system of group- based concession schemes, as recommended by the ERC. The scheme involves fixing a uniform concession under five groups of plants. These are: (i) pre-1992 gas-based plants (ii) post-1992 gas-based plants (iii) naphtha-based plants (iv) fuel oil-based plants and (v) plants based on mixed feedstock.

The Government has also proposed linking the concession support for naphtha- and fuel oil-based plants to the prevailing import parity prices (IMPP) of the feedstock, against the reasonable actual cost used for determining the retention price (RP) under the RPS. A major objective of the concession scheme mentioned in the ERC report is to protect the viability of all efficiently run plants and maintain a reasonably high level of self- sufficiency in urea availability. The implications of implementing the scheme need to be carefully assessed with reference to these fundamental objectives.

At the outset, let us look at the manner in which the concession rates have been determined. The ERC has computed these on the basis of the weighted average of the RPs of individual plants under the existing dispensation. Thus, for the naphtha group, the weighted average being Rs 13,000 per tonne, the concession will be Rs 8,400 per tonne (13,000-4,600). The above will lead to lower price realisation for units whose existing RP is higher than the average, and higher realisation for those where the RP is below the average. Thus, even as the former will lose, the latter will gain. Significantly, there will be no savings in subsidy.

Even as the ERC has shown a saving of about Rs 100 crore, purportedly on account of restructuring the pricing scheme, it is primarily the result of adopting a peculiar rounding-off technique; for instance, the average figure of, say, Rs 13,060 is taken as Rs 13,000! Despite there being no saving in subsidy, why has the ERC recommended a switchover to a group-wise concession scheme? The standard argument put forward in the ERC report, and repeatedly emphasised by various Committees, including the High-Powered Fertiliser Pricing Policy Review Committee HPC (1998), is that a unit-specific dispensation such as the RPS does not exercise pressure on the producers to improve efficiency and reduce cost; and that a uniform pricing regime would help remove these anomalies.

The situation on the ground needs to be studied carefully, with specific attention to the prime determinants of production cost. Thus, energy cost per tonne of urea (a major component of overall production cost) equals its delivered cost (at plant site) in rupees/million Kilo calories, multiplied by the number of million K.cal needed for a tonne of urea. Now, if a unit has to aim at low cost, both these factors need to be tackled.

As regards efficiency — that is, the number of million K.cal needed to produce a tonne of urea — fairly tight norms under the RPS have led to significant improvements. Thus, for naphtha-based plants, energy consumption per tonne of ammonia fell from 12.78 million K.cal in 1987-88 to 10.41 million K.cal in 1998-1999. For gas-based plants, it declined from 10.22 million K.cal in 1987-88 to 8.92 million K.cal in 1998-1999.

Thus, the delivered cost of energy — rupees/million K.cal — depends on the feedstock used — naphtha, fuel oil/LSHS, gas, etc. — and the plant's location. Since the feedstock is sourced from oil and gas corporations owned and controlled largely by the Government, it is the latter which fixes their basic prices. The prices are, therefore, beyond the unit's control.

Within any given group, the costs differ due to the differential effect of freight and local taxes, depending on the location. Thus, the difference between the minimum and maximum costs of naphtha could be as high as Rs 3,000 per tonne. Likewise, the cost of gas could vary up to about Rs 1,000 per thousand cubic metre. As a result, production costs are bound to differ even if energy consumption per tonne urea is the same. There are unavoidable variations in energy consumption as well.

For instance, an old vintage plant using old generation technology simply cannot match the efficiency levels of new plants. Even after modernisation requiring substantial investment, the former may still not be able to come close to the level achieved by the latter.

The ERC has taken cognisance of the industry's heterogeneity only to the extent of differentiating plants according to feedstock. It has ignored significant variations within each group. As a result, under the scheme, plants incurring high cost (largely beyond their control) will be unjustifiably penalised, leading to their eventual closure.

In view of above, implementation of the scheme could lead to a loss of about 30-40 per cent of domestic production. It would jeopardise continued self-sufficiency in urea, leading to greater dependence on imports and the resultant exploitation in the world market by way of high prices, besides problems of availability.

The contentious issue of whether we should move towards a uniform pricing regime cannot be decided merely in terms of the overall spirit of liberalisation and globalisation. We cannot be oblivious of the ground realities and simply allow a significant part of the industry to be decimated. The objective of reforms should be to make units do better, not kill them.

Notwithstanding the above, if the Government is determined to go ahead, it should make concerted efforts for creating a situation in which uniform prices will not cause any serious disorder. The focus should be on tackling the prime causes of heterogeneity; in particular, the external factors beyond control of individual plants. The following steps should be taken, without delay: First, the oil companies should be advised to start fixing the ex-refinery prices of naphtha, fuel oil and LSHS on a uniform basis. This was indeed, the practice prevailing before April 1, 1999.

Second, the oil companies should charge user industries towards freight cost on a uniform basis, irrespective of distance from the refinery/storage point. The equalised freight may be fixed in a way which ensures that their overall realisation towards transport cost is not affected.

Third, the State governments should be prevailed upon to charge sales tax on a uniform basis. This was, in fact, the consensus decision at the Conference of Chief Ministers last year. They should all aim at a rate of no more than 4 per cent.

Fourth, in respect of gas, now, only plants along the HBJ pipeline pay transport charge of Rs 1,150 per cubic metre. GAIL should be advised to charge for the cost of carrying gas on a uniform basis from all user industries, including plants located onshore.

With these measures, it should be possible to bring about a general uniformity in the delivered cost of feedstock under each group. This, together with steps taken by units — particularly vintage plants — for revamp/modernisation (FIs should provide them the necessary support), will create a conducive environment for a smooth change-over.

The Government should refrain from introducing the concept of IMPP for feedstock in determining the concession rates until manufacturers get the full freedom to import (under the EXIM policy, naphtha continues to be on restricted list), and domestic oil companies charge for their supplies on this basis.

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