21 March, 2002 THE HINDU BUSINESS LINE

Urea pricing: Challenges before ministerial group

Uttam Gupta

AT A recent meeting of the Cabinet Committee on Economic Affairs, the Government has decided to constitute a Group of Ministers under the Chairmanship of Mr K. C. Pant, Deputy Chairman, Planning Commission, to look into the contentious issue of the changes in policy parameters under the seventh and the eighth pricing periods — July 1, 1997 to March 31, 2000 and April 1, 2000 to March 31, 2003 — for fixing the retention prices of urea units. The impact of the contemplated changes needs to be evaluated carefully. At the outset, let us take a look at the changes reportedly mooted by the Department of Fertilisers. These are:

- the reassessment of the production capacity of plants with effect from April 1, 2000 based on Dr Alagh Committee recommendations (reassessment is mooted for seven plants based on naphtha and fuel oil, for which the Committee did not make any such recommendation);
- the withdrawal of the vintage allowance (now available for plants more than 10 years old) in respect of capacity utilisation with effect from April 1, 2001 and energy consumption with effect from February 1, 2002;
- the revision in consumption norms during the eighth pricing period based on actual during 1999-2000; likewise, it is proposed to revise the consumption norm during the seventh pricing period based on the actual in 1997-98;
- the increase in the capacity utilisation norm by 5 per cent per annum to reach 100 per cent by 2003-04 for gas-based plants, and 2004-05 for plants based on naphtha and fuel oil.

To get an idea of the likely impact of the proposed changes, let us consider a typical gas based plant of 1,350 tonnes per day ammonia capacity and commensurate urea capacity. In May 2000, the Government had issued a notification to 'provisionally' reassess the capacity of such a plant to 1,500 tonnes per day ammonia. On an annual basis, this is 4.95 lakh tonnes (330 stream days). In terms of urea, the capacity works out to 8.53 lakh tonnes per annum. For a vintage plant, the capital related charges (CRC) and other fixed costs are reimbursed at 85 per cent of this level; for others, this is 90 per cent.

As per the Dr Alagh Committee recommendations, the ammonia plant capacity will be revised from 1,500 tonnes per day to 1,520 tonnes per day. Correspondingly, the reassessed capacity of the urea plant will increase from 8.53 lakh tonnes per annum to 8.65 lakh tonnes per annum. Following withdrawal of the vintage allowance from 2001-02, the normative production level will be 90 per cent of this. During 2002-03, this will be increased to 95 per cent and by 2003-04, this will reach 100 per cent of the reassessed capacity, or 8.65 lakh tonnes per annum.

In view of the above, from 2003-04 onwards, the manufacturing unit will have to produce 8.65 lakh tonnes of urea per annum to ensure full recovery of the CRC and other fixed costs. Further, it will have to sustain the energy consumption level achieved during 1999-2000 to prevent any under-recovery of energy cost. This by itself will not ensure the promised return of 12 per cent unless reasonable costs incurred by the unit under various heads are allowed in full. On all the three fronts, the prospects are bleak!

The ability of units to maintain production at 100 per cent of the reassessed capacity is extremely doubtful. This is because while, on the one hand, the demand for urea is unlikely to show extraordinary growth, on the other, the Government is keen to create space for imports. Further, there will be supplies of 1.5 million tonnes urea per annum from the Oman JV committed under the buy-back agreement. This material will start flowing in from 2004-05.

Under the new policy, the energy consumption norm will be pegged at the 'actual' of 1999-2000. That was a good year, when the units operated at high capacity utilisation, leading to significant improvement in energy consumption. By definition, the 'best' cannot be achieved on a sustained basis. And, with the imminent cut in the Essential Commodities Act allocation (during rabi 2001-02, the Government has resorted to significant reduction in view of excess availability), restriction on production is inevitable. This will affect energy consumption.

Finally, the units face substantial 'disallowances' under various cost heads — project cost, capital addition, conversion cost, working capital, marketing/selling expenses and taxes/duties. As a result, the units have not been able to achieve the promised return despite operating at high efficiency levels. (And because of the imposition of a ceiling on production at 100 per cent of the reassessed capacity, since 2000-01, the situation has deteriorated further).

zIn view of the Governments' commitment to rein in subsidies, it is unlikely that all reasonable costs will be allowed in full.

Under the proposed policy package, the Government has set high standards of performance without creating an enabling environment for the manufacturing units to reach these levels. Implementation of this package will erode the margins and push several units into the 'red'. The Group of Ministers should restructure the package keeping in mind the overriding need to enable all 'efficiently' operated plants achieve the promised return and ensure continued health of the industry.

(The author is Additional Director (Economics), Fertiliser Association of India, New Delhi. His views are personal.)