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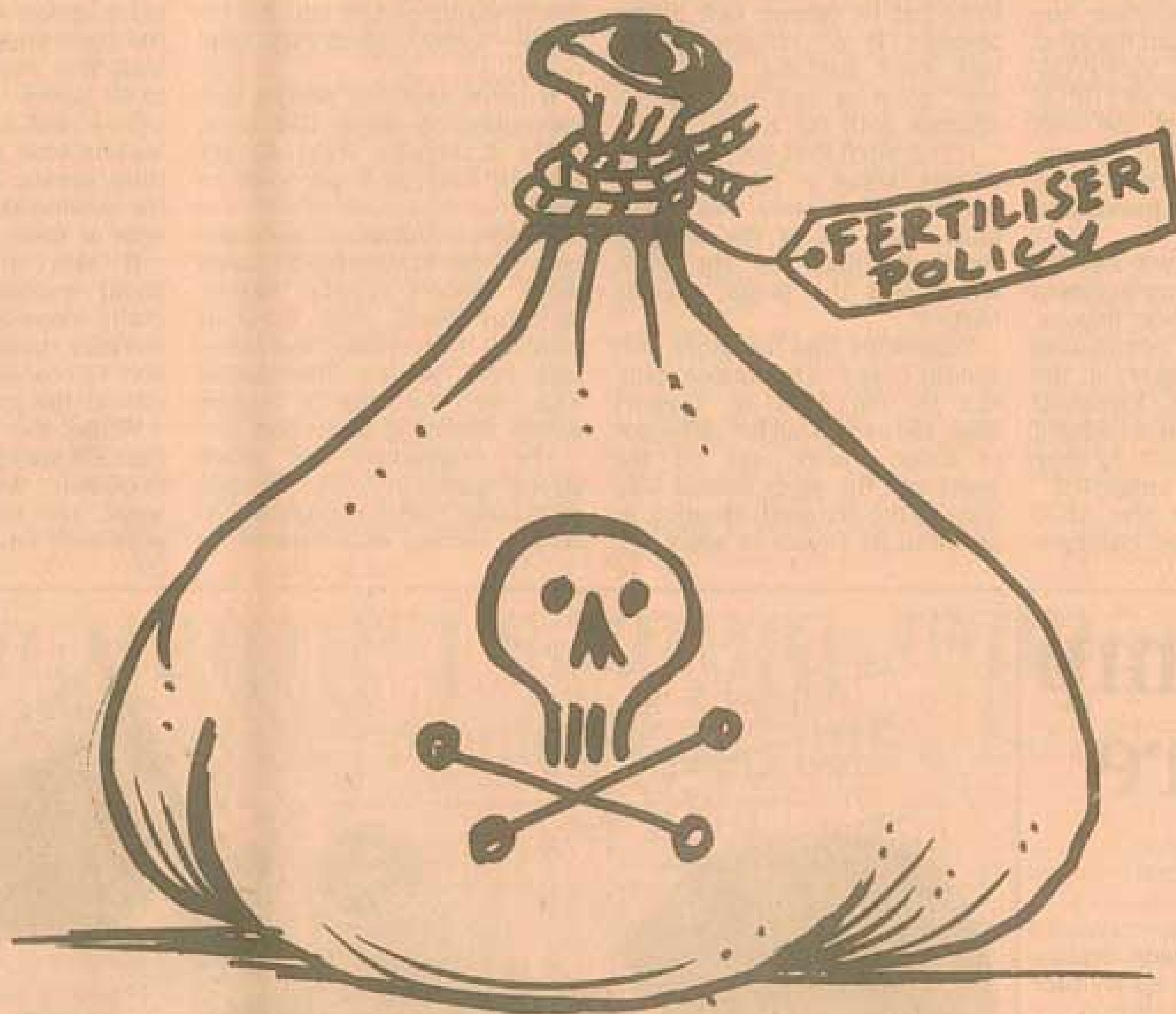
EDIT PAGE

A self-defeating package

The package on fertiliser will scare away future investment and undermine the existing units, says **Uttam Gupta**



THE high-powered Hanumantha Rao Fertiliser Pricing Policy Review Committee which submitted its report on April 3, 1998 to the Union minister of chemicals and fertilisers, has rejected the much-touted theory of taking domestic investment decisions on the basis of import parity pricing (IMPP), considering the high volatility of international prices.

Recognising the fact that the entry of a major importer like India in the international market will push up the world market price, it has recommended that we need to adopt positive policies which attract investment in the industry and ensure that the level of self-sufficiency in fertilisers is not eroded to unacceptable levels.

The Committee has a word of praise for the retention pricing and subsidy scheme (RPS) — the epicentre of the fertiliser policies followed in the late 70s and 80s — and has duly acknowledged its contribution in promoting investment and facilitating healthy growth of this vital industry. And yet, it has recommended dismantling of the RPS based merely on the impression that the system does not put pressure on the producers to improve efficiency and reduce cost.

The Committee seems to have little interest in knowing that the Indian fertiliser industry has achieved performance standards comparable to the best in the world. For instance, the average energy consumption for gas-based plants in India was 9.18 million k cal per tonne of ammonia during 1995-96 as against 9.93 million k cal for the American industry. Excluding Namrup, a sick plant, the former was even lower at 8.86 million k cal.

The Committee has recommended introduction of a uniform pricing system based on LRMC method. According to the definition given in the Report, LRAC of a new unit that gives the incremental output represents the LRMC of the industry. Then, it computes LRAC of two new grassroot projects and two expansion projects — all based on gas — following the principle laid down by BICP and using relevant data on investment cost, normative production, variable cost (VC) and other operating cost.

The LRAC of these 'four' units is averaged to yield a price of Rs 6050 per tonne. This is recommended as the normative referral price (NRP) for all existing gas-based units w e f January 1, 1998. Additionally, the committee has recommended what is termed as Feedstock Differential Cost Reimbursement (FDCR) for naphtha/coal-based plants at Rs 1750 per tonne and for fuel oil/LSHS-based plants at Rs 1300 per tonne. This is to compensate for the handicap of these units due to inherent lower efficiency of the feedstock and their higher cost vis-a-vis gas.

The Committee's recommendations thus boil down to giving NRP of Rs 6050 per tonne to gas-based plants, Rs 7800 per tonne to naphtha/coal-based plants and Rs 7350 per tonne to FO/LSHS-based plants. For majority of the plants, the NRP is lower — in several cases substantially lower — than the retention price (RP) received under existing dispensation.

Amongst the gas-based plants, seven out of a total of 15 will have NRP lower than RP, resulting in loss of about Rs 574 crore (1997-98 production level). The balance eight, whose NRP is higher than RP, will gain to the extent of about Rs 784 crore. In this, however, two units alone account for about 70 per cent. For all gas-based units put together, in the net, there will be gain of Rs 210 crore.

All plants based on naphtha and coal will have NRP lower — in several cases substantially lower — than RP, thus resulting in loss of about Rs 397 crore to naphtha-based units and Rs 43 crore to coal-based plants. In the fuel oil/LSHS category, all units but one will incur loss of about Rs 103 crore. Minus the gain of one, the net loss would be Rs 76 crore.

The Committee has also recommended a ceiling of Rs 450 per tonne towards freight and distribution margin. This, too, falls significantly short of the corresponding allowance for majority of units under the existing dispensation. The resultant loss on this account would be about Rs 294 crore. All put together, the industry will lose to the extent of about Rs 600 crore.

The above computations are on the basis of the latest notified RPs. However, there are several escalation claims pending, for instance, increase in price of natural gas w e f January 1, 1998. After RPs are adjusted to reflect these, the extent of loss-making units under the NRP regime will increase while gains of gaining units will reduce. The overall loss position for the industry will, thus, worsen.

The gain to gainers in the category of gas-based plants is largely due to the fact that while the NRP is arrived at on the basis of delivered cost of gas along HBJ, these units are located onshore/at landfall points and, therefore, do not incur transport charge (Rs 1150 per thousand cubic metre), thus resulting in corresponding savings.

When it comes to implementing the system, possibility of this gain being treated as fortuitous and, therefore, mopped up is not ruled out. That the government is all the time keen to save on subsidy could well prompt it to take away this benefit which, indeed, is substantial. As a result, even these plants could also be in difficulty.

Apart from threat to their viability, the affected units will face a serious liquidity crunch. Let us consider a new gas-based plant along HBJ with urea capacity of 7.68 lakh tonne per annum. Due to shortage of gas, it has to supplement energy supply from naphtha — to the extent of 25 per cent. The latter's price is about Rs 820 per million k cal as against former of Rs 425 per million k cal.

With these price levels, the weighted average cost of energy comes to about Rs 524 per million k cal. Taking 6 million k cal needed for producing a tonne of urea, energy cost alone is Rs 3144 per tonne. Add bagging about Rs 250 per tonne, VC is Rs 3400 per tonne. Conversation cost (CC) accounts for another about Rs 800 per tonne. Thus, VC plus CC is Rs 4200 per tonne.

At the NRP of Rs 6050 per tonne and after deducting these costs, the balance available for meeting capital related charges (CRC) will be only Rs 1850 per tonne or Rs 142 crore at normative production of 7.68 lakh tonne. Against this, the actual liabilities towards repayment of loans, interest and dividend pay out is more than double, i e about Rs 300-325 crore.

In a nutshell, quite contrary to the assertion by the Committee that the country will need positive and stable policies to maintain certain minimum level of self-sufficiency in fertilisers, the policy package recommended by it will not only scare away future investment but also undermine the viability of existing units. The Committee's Report needs to be subjected to an objective examination. The government should carefully consider the serious implications of implementation.