

# Dependence on economic criterion misleading

## Strategic factors must be the chief yardstick for setting up new fertiliser projects in the country

by **UTTAM GUPTA**

**I**N the first part of the article published on September 17, 1999, it was argued that the production cost of urea from the proposed expansion project would be a whopping Rs 7,200 per tonne higher than the cost of imported urea at the prevailing depressed international price of \$85 per tonne C&F. On this basis, therefore, the project would appear to be unviable.

It is significant to note that the energy cost alone at about Rs 6,600 per tonne for an efficiently run plant (energy consumption assumed at 6 million K.cal for a tonne of urea) exceeds the

cost of imported urea by a substantial Rs 2,200 per tonne. Consequently, even if the cost of servicing the capital and conversion cost viz. wages and salaries, other overheads, chemicals and catalysts, repairs and maintenance etc. is nil which is theoretical, it would still not be possible to sustain the operations.

In view of the above, if the approach adumbrated by PIB is followed then, we should not even think of setting up any new project, expansion or grassroot. Extending this to existing plants would mean that all units based on naphtha and fuel oil should be dumped. This is because their energy cost alone will be substantially higher than Rs 4,400/3,500 per tonne. In fact, due to vintage resulting in higher energy consumption, the gap will be even greater than for a new project.

Even gas based plants will not be safe. Currently, delivered cost of gas to HBJ plants is about Rs 440 per million K.cal. They have to use liquid hydrocarbons viz. naphtha to the extent of about 25 per cent due to shortage of gas. This is conse-

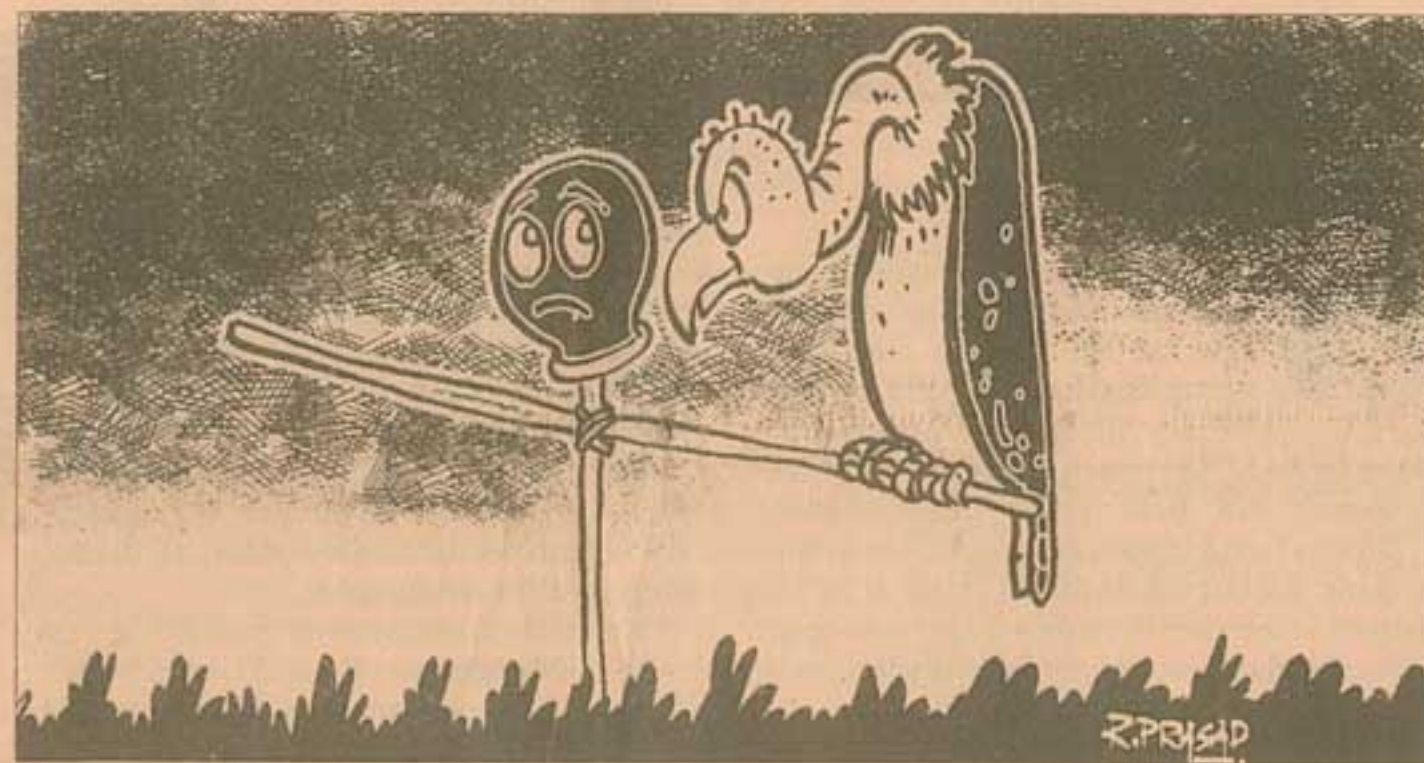
quent to the directive issued by the ministry of petroleum and natural gas (MPNG), in the early 90s, denying supply of gas to plants along HBJ pipeline for use in captive power and steam generation plants. Subsequently, plants located on-shore were also covered by the cuts.

In view of the above and the cost of naphtha being substantially higher i.e. about Rs 1,100 per million K.cal, the effective energy cost works out to about Rs 600 million K.cal ( $440 \times 0.75 + 1100 \times 0.25$ ). With this, even for an efficiently run gas based plant, the production cost of urea works out to about Rs 3,600 per tonne. This is higher than net-back from selling price of Rs 3,500 per

tonne leaving no money to cover capital related charges (CRC) and conversion cost (CC). Although, this is lower than import cost by Rs 800 per tonne, this differential will be grossly inadequate to cover CRC and CC.

The logical outcome of looking at things from the PIB mind-set will be unprecedented loss of domestic production leading to corresponding increase in imports. This, in turn, will push up international price as in the past; for instance, during 1995-96, when, we imported 3.78 million tonnes, C&F cost was \$240 per tonne (even in 1996-97, this was \$206 per tonne corresponding to imports of about 2.32 million tonnes) and, in mid 70s, when, we imported 50 per cent of our needs, this was \$300 per tonne.

Currently, international price is low because India and China have rapidly built up their domestic production capacity and, as a result, reduced imports drastically. Urea imports by India declined from 2.4 million tonnes in 1997-98 to 0.56 million tonnes during 1998-99 and are expected to be about 0.5 million tonnes dur-



ing 1999-2000. Imports by China declined from 6.3 million tonnes during 1996 to 3.5 million tonnes in 1997 and further to a minuscule of 0.22 million tonnes during 1998. During the current year, it is likely to be about 1.0 million tonnes.

With demand continuing to increase, if either India or China or both turn complacent, do not add to capacity or even think in terms of disbanding a part of existing capacity, we could soon get into a vicious circle of high import price. Although, at that point, on economic criterion, setting up a new project would be viable and existing units would look highly attractive, it would be too late in the day.

A decision on whether project should be set up or not, has to be guided solely by strategic fac-

tor. Essentially, we need to look at projected gap between demand and supply (from existing units) and accordingly, take a view on required addition to capacity and number of projects to support it. Individual projects may be prioritised on the basis of investment cost and energy use efficiency.

There is an urgent need to rein hydrocarbon prices to ensure cost competitiveness of Indian industry. For instance, if, only feedstock is charged to plants at the same rate as in Middle East i.e. less than \$1 per million Btu (as against current naphtha rate of about \$6.5 per million Btu), they could supply urea even cheaper than present highly depressed cost of import.

*The author is chief economist, Fertiliser Association of India, New Delhi*