

Fert bandwagon could be a trap

Uttam Gupta asks if the big corporate entities getting into this area have looked closely at the pluses and minuses

SUDDENLY, some of the big names on India's industrial horizon have started seriously considering setting up of fertiliser projects. In the early 80s, of the six gas-based mega urea projects committed along the HBJ pipeline, four were earmarked for the private sector. Apart from this, there is some investment activity in the public / cooperative sector.

Before the new promoters venture into this ball game and commit heavy investments including public money, they need to evaluate carefully the prospects with regard to project viability. Assuming that they finalise their investment intentions and related formalities by end of this year, and set the zero date as April 1, 1996, allowing for a gestation period of about 36 months, the projects can hope to commence commercial production at the beginning of 1999-2000. From the viability angle, three factors will be crucial: i) Likely cost of production and distribution from these plants ii) the farmgate cost of supplying urea through imports and iii) what price the farmers would be willing to pay.

The main determinants of cost of production are the investment cost and the feedstock cost. The latter, in turn, is dependent on the type of feedstock used. Natural gas is unambiguously more cost-effective than naphtha or fuel oil in terms of both investment and operating cost. Let us ignore this for a moment and consider the new project to be based on gas which, indeed, is the expressed intention in the case of Reliance and the Dalmias. The feedstock cost per tonne of urea is unlikely to be lower than an existing gas-based unit.

As regards the investment cost, the new projects which would see the light of the day three years from now, will be at a disadvantage vis-a-vis the existing new units in view of the sheer factor of inflation alone. That the former will get the benefit of elimination of customs duty on fertiliser project imports is not of any great consequence because of two reasons. First considering that this decision was implemented in 1992 even the Chambal, the Tatas and Bindal Agro have also been the beneficiaries as the bulk of their equipment was imported after that. Second, the anticipated depreciation of the rupee, will handicap them further.

Clearly, the cost of production and distribution of urea from these projects will be significantly higher than the Chambals or the Tatas. The latter, by itself, is not less than Rs 9,000 per tonne. This brings us to the second critical element i.e.: the cost of imported urea. At the prevailing C&F landed cost of about \$ 225 per tonne, the corresponding farmgate cost will be about Rs 8,200 per tonne. In comparison with imports, thus, even the existing new units are already at a disadvantage. The contemplated projects could be much worse. Moreover, the international prices of



urea are highly volatile and the possibility of substantial reduction in a short span is not ruled out. In fact, only about two years back, the C&F landed cost of imported urea was \$ 130 per tonne. In the event of prices touching this level again the corresponding farmgate cost of imported urea could be about Rs 5,100 per tonne. In such a situation, the new projects will be rendered completely unviable.

The third critical element i.e. the selling price of urea presents even greater imponderables. Presently, this is Rs 3,320 per tonne. Sounds unusual! But, this is possible because urea is covered by pricing and distribution controls. While on the one hand the Government controls its selling price at a low level to make it affordable to farmers, on the other, it fixes a fair ex-factory price, commonly known as the retention price. The difference between the two is reimbursed as subsidy to the manufacturer. The cost of transporting from the factory to the consumption point is separately reimbursed as equated freight. The excess of the cost of supplying imported urea over the selling price is also subsidised by the Government.

In view of this and subsidy support under the RPS, it is possible for new units like the Chambal's or the Tata's to remain viable despite their farmgate cost being above Rs 9,000 per tonne. If this dispensa-

It would be suicidal for the entrants to proceed solely on the basis that the retention pricing scheme would continue indefinitely

tion were to continue indefinitely, then, even those who are contemplating to set up fresh projects now, will also remain viable. But, whether or not the system will continue and, for how long, is a million-dollar question?

It is necessary to assess the viability in a situation when RPS is not there. That means no subsidy support from the Government and if a unit is to remain viable, the farmer should be ready to pay for its full cost of production and distribution.

For this, it is important to see as to what he is paying now and what he would be willing to pay at the time when these new units start selling their product. Clearly, Rs 3,320 per tonne is an unrealistic price; it will not prevail in a free market decontrolled situation. The likely price could be the one at which bulk of the supplies could be arranged. Presently, for the industry as a whole, the farmgate cost on a weighted average basis works out to about Rs 5,500 per tonne. Whether or not the farmers are ready to pay even Rs 5,500 per tonne is a big question mark as even at this level the price would be 65 per cent more than they are paying now. But, assuming that they decide to pay, the new projects would be at a whopping disadvantage of about Rs 4,000 per tonne plus. Will they be able to sell their product?

It might be argued that with the

demand for urea substantially exceeding the likely supply, it would be possible to find a market for all and sundry including for the high-cost urea from new units. There is need for caution here particularly with regard to demand-supply scenario. Let us look at the likely supply. During 1994-95, nitrogen production in the country, was 79.4 lakh tonnes. The Tata's plant at Babrala, Bindal Agro's plant at Shahjahanpur, Iffco-Aonla expansion, NFL-Bijaipur expansion will give an incremental urea production of about 31 lakh tonne.

The proposed rehabilitation of FCI/HFC as per the plans finalised by the group of Central Ministers will give an additional 23 lakh tonnes per annum. Together, this would yield an incremental domestic production of about 54 lakh tonnes. Then, there is the Oman joint venture with a production capacity of 15 lakh tonnes per annum urea which would be available to us under a buy-back arrangement. All put together, this makes for about 69 lakh tonnes of incremental additional urea or about 32 lakh tonnes of Nitrogen to the overall supply kit. Together with the present production of 79 lakh tonne, the likely supply that we are talking of by the turn of the century would be about 111 lakh tonnes.

As against that, consumption of nitrogen during 1994-95 was about 92 lakh tonnes. During the last 10 years or so, N use has increased at the rate of about 3.7 lakh tonnes nitrogen per annum. It is unlikely that the pace of addition to nitrogen demand in the future will be more. On this basis, the likely N demand by 1999-2000 would be about 111 lakh tonnes. No doubt, the Eighth Plan Working Group on Fertilisers (1989) had projected the nitrogen demand of about 127 lakh tonnes by 1999-2000; however, this target looks unrealistic in the light of the unfolding trends. We also need to recognise that the emerging policy environment will be such that the selling prices to the farmers will be much higher than they have been hitherto. The adverse effect of this on consumption has also to be taken into account.

With the likely demand and supply of nitrogen more or less balancing, it is anybody's guess whether those who are contemplating to set-up fresh projects for urea, would be able to make space for themselves particularly when their costs will be substantially more than that of the existing units. Their prospects will not improve even if some deficit is generated either because of anticipated demand being more than 111 lakh tonne or a part of the assumed capacity addition not materialising.

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