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Misuse of import parity

by UTTAM GUPTA

BARELY 14 months ago, from July 3, 1996, the so-called concessional prices of naphtha, fuel oil and LSHS supplied to the fertiliser industry were increased by 30 per cent each. Consequently, the basic prices (ex-refinery), were naphtha Rs 4,840 per tonne, fuel oil Rs 3,916 per tonne and LSHS Rs 3,707 per tonne. With effect from September 2, 1997, the prices have been further jacked up.

The ex-refinery price of naphtha goes up by 57.5 per cent to Rs 7,624 per tonne, fuel oil 40.6 per cent to Rs 5,507 per tonne and LSHS 64 per cent to Rs 6,089 per tonne. On landed cost basis, the increases are even sharper due to the cascading effect of sales tax levied ad valorem. While, the impact may vary depending on the location, in the case of Zuari Agro Chemicals Ltd (ZACL), Goa, for instance, the cost of naphtha rises 60 per cent from Rs 5,804 per tonne to Rs 9,287 per tonne and that of fuel oil 44 per cent from Rs 4,827 per tonne to Rs 6,953.

As a result, the production cost of urea and that of complex phospatic fertilisers using domestic ammonia based naphtha/fuel oil/LSHS, will increase leaps and bounds. For instance, the cost of ZACL products will increase - urea by about Rs 1,100 per tonne etc., - entailing an additional expenditure of about Rs 42 crore per annum. Other will also have to cough up huge sums eg., Duncan Industries Rs 104 crore, Sri Ram Fertilisers & Chemicals about Rs 53 crore and MCF Rs 60 crore etc. The additional burden on the industry will be about Rs 1,500 crore per annum.

Whereas, for urea, this will be reimbursed through corresponding increase in subsidy under the retention pricing and subsidy scheme (RPS), the manufacturers of phospatic fertilisers - already decontrolled - will be left high and dry. The manufacturers of urea will not remain unaffected. This is because under the existing formula of recognising variable cost (VC), adjustment of RP to reflect the impact of increase in input cost is a time consuming process. This results in liquidity problems hampering production and loss of profitability as interest cost for period of delayed payment is not compensated by the FICC.

In the eventual decontrol regime, the high cost of production will make the units highly vulnerable. At the revised prices, the cost of naphtha to a unit is about $6 per million Btu. Taking about 28 million Btu needed for one tonne urea, energy cost alone will be $168 per tonne. With this, it will be virtually impossible to sustain production by these plants despite high efficiency level.

In the 1990s, even the so-called concessional feedstock prices were raised four times i.e., October 1990, July 1991, September 1992 and July 1996. As a result, the basic price of naphtha (ex-refinery) had already shot up from Rs 1,982 per tonne at the beginning of the decade to Rs 4,840 per tonne last year i.e., an increase of about 145 per cent. Likewise, the price of fuel oil and LSHS increased by 175 per cent and 177 per cent respectively.

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Whereas, in the past, the government did not even bother to provide any convincing explanation for the price hikes, but has come up with some logic for the recent increase from September 2, 1997. It has decided, in principle, to link the basic price (ex-refinery) of naphtha, fuel oil and LSHS to the prevailing import parity price. However, while implementing this concept too, it has bungled.

The prevailing c&f cost of imported naphtha is about $180 per tonne. Minus ocean freight of about $20 per tonne from the Middle East, the FOB realisation to the supplier from abroad is $160 per tonne. On this basis, domestic naphtha should be priced at about Rs 5,840 per tonne (160 x 36.5). As against this, the ex-refinery price has been fixed at Rs 7,624 per tonne which is higher by Rs 1,784 per tonne.

It would appear that for arriving at the ex-refinery price, ocean freight and port charges have been included. This is illogical and totally contrary to the spirit of pricing on import parity basis. By selling the product in the international market, all that the foreign supplier realises is the FOB price. There is a built-in contradiction in this approach as, on the one hand, the government proposes to link pricing of the domestic product to what happens in the international market, on the other, it loads on to the price, the effect of its own actions e.g., fixing port charges etc. The logical approach is to fix the ex-refinery price on the basis of the FOB price as this indeed, is the realisation to the oil companies abroad and our companies too would be realising the same price if they were to export the product.

In reply to a question in the Rajya Sabha on March 13, 1997, the government stated that the cost of production of naphtha on a weighted average basis including the cost of marketing margins and excise duty - this is virtually ex-refinery cost - was Rs 5,844 per tonne during 1993-94, Rs 5,918 per tonne in 1994-95 and Rs 6,012 per tonne in 1995-96. Whether these numbers are based on efficiency norms is not known. Unlike RPS for fertilisers which is fairly transparent, the pricing of POL products is shrouded in secrecy. Even taking the stated cost on face value, to fix an exorbitant price of Rs 7,624 per tonne is taking unfair advantage of the monopoly status of government-owned oil companies. ◆