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Pampering gas sector at the cost of fertilisers

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BARELY three months after the steep hike in prices of natural gas and transport charges along the HBJ pipeline from October 1, 1997, the government has struck again. Effective January 1, 1998, its basic price to consumers has been increased from Rs 2,150 per thousand cubic metres (calorific value: 10,000 k-cal) to Rs 2,411 per thousand cubic metres. This indicates a hike of Rs 261 per thousand cubic metres. To users located in the north-east, the prevailing concessional rate has gone up from Rs 1,200 per thousand cubic metres to Rs 1,315—up by Rs 115 per thousand cubic metres.

The price to the producer (primarily ONGC which supplies most of the bulk natural gas requirements of India, except the north-eastern region which is served by Oil India Ltd) has been correspondingly increased from Rs 1,800 per thousand cubic metres to Rs 2,003—an increase of Rs 203 per thousand cubic metres. The corresponding increase in royalty of 10 per cent and CST of four per cent—levied on the producer price—would be Rs 29.2 per thousand cubic metres.

The plants located at the landfall plant and those using onshore gas get gas having a calorific value (CV) of about 9,000 k-cal even as the price is linked to a k-cal of 10,000. In view of this, additional rebate on account of the shortfall in CV is given as per a formula. The net increase in delivered cost to these plants at the factory tap works out to Rs 287 per thousand cubic metres. For plants along the HBJ pipeline which get gas at a CV of about 8,500 k-cal, the increase works out to Rs 260 per thousand cubic metres.

On supplies to users in the north-eastern region, OIL was receiving a price of Rs 1,900 per thousand cubic metres. The producer price now being Rs 2,003 per thousand cubic metres, the increase is Rs 103 per thousand cubic metres. Additional royalty at 20 per cent (there is no CST in the north-east) works out to about Rs 21 per thousand cubic metres. After taking the CV rebates and other factors, the increase in final delivered cost is Rs 132 per thousand cubic metres.

The likely consumption of gas by fertiliser plants located at the landfall point, or those using onshore gas, is about 3.08 billion cubic metres per annum; for plants located along HBJ the figure is 3.742 billion cubic metres and for plants in the north-east about 313 million cubic metres per annum. Following the increase in the delivered cost of gas for different categories of plants, the additional expenditure by the fertiliser industry would be about Rs 190 crore per annum.

The bulk of this is on urea manufacturing covered by the retention pricing and subsidy scheme (RPS). Since the selling price of urea—kept at a low level to make it affordable to farmers—remains unchanged, this will lead to a corresponding increase in the subsidy outgo from the exchequer. This will, in fact, be more than the extra revenue to ONGC/gas pool because a portion of the additional royalty goes to states, the whole of the incremental sales tax goes to state governments, and there is the cost of additional working capital due to the increase in price. In the net, the central exchequer will lose.

This is not an isolated case. In the past, whenever administered prices of various hydrocarbon feedstocks/fuels have been raised, although these increased the surpluses with the oil/gas pool accounts, there was also a corresponding increase in fertiliser subsidy under the RPS by a much larger amount. Therefore, in effect, the exchequer has all along been a loser. Needless to say that, in the process, huge resources have been transferred to the states—by way of higher sales tax collections—outside the scope of the Finance Commission Award.

The RPS is currently being reviewed by the Hanumantha Rao Committee. Under a new regime—based on the committee's recommendations—it may be argued that the government need not give any subsidy support. But then, this would require suitable increases in the selling price for the producer to remain viable. Presently, the price of urea is Rs 3,660 per tonne as against a reasonable cost of production and distribution on a weighted average basis of about Rs 7,500 per tonne. The gap is huge because, in the past, the price was either not raised at all—as in the 1980s—or increased at a snail's pace, as in the 1990s. The cost of production/supply increased sharply due to steep increases in the prices of inputs, including feedstock, utilities such as power, water and services, and railway freight.

The Ninth Plan Working Group on Fertilisers has recommended an increase of only 10 per cent per annum, beginning 1998-99, for four years. On this basis, by the year 2001-02, urea prices would reach about Rs 5,350 per tonne only. Thus, even the existing gap will remain substantially uncovered, not to talk of further escalation due to the linkage of gas prices to 65 per cent of the price of international fuels in 1998-99, 75 per cent in 1999-2000 and 100 per cent thereafter.

If the selling price cannot be suitably increased and, under the new scheme of things, even the subsidy has to be kept under check, then the only option may be to deny manufacturers compensation for the higher cost on account of ever increasing prices of feedstock and other inputs. Is that a practical proposition? Certainly not. There is no way that the producers can absorb these shocks.

The notion, in some quarters, that producers should do so by improving efficiency is ridiculous. Under RPS, pricing is fixed on the basis of efficiency norms in regard to capacity utilisation and consumption of raw materials and utilities. These are fairly stringent and have, in fact, been tightened over the years (eg., the increase in utilisation norm for gas-based plants from 80 per cent to 90 per cent, etc.) Even the JPC (1992) adversely commented on this unhealthy trend.

That apart, it is illogical and unjustified to expect the producer to neutralise the effect of an input price hike through improvements in efficiency. After all, there are design/equipment limits and it is impossible to go beyond the threshold. For instance, to a gas-based plant along HBJ, at a delivered cost of about Rs 350 per million K-cal prior to October 1997 and taking six million k-cal for a tonne of urea, the energy cost is Rs 2,100 per tonne. The current gas cost being about Rs 430 per million k-cal (w.e.f January 1, 1998) energy consumption will have to be reduced to 4.8 million k-cal for a tonne of urea if the plant were to fully absorb the impact. An impossible task indeed.

Such an approach is bound to turn units sick leading to their eventual closure. The resultant huge loss of domestic production will have to be made up by imports. This, in turn, will lead to a spurt in international prices of urea and the government will end up incurring much higher subsidies. Besides, there will be problems of availability of the required quantity of material, foreign exchange and infrastructure for handling at ports and for internal transportation to consumption points.

There is nothing like a free lunch. You cannot have a situation whereby the oil/gas pool keeps on getting more and more surpluses (read: ever-increasing feedstock prices); where farmers—consumers of fertilisers—do not have to pay for it; where the fertiliser subsidy burden on the exchequer does not increase and, yet, an increasing supply of fertilisers from the industry is assured.

The government should evolve a coordinated policy to strike a judicious balance amongst all these equally vital concerns. Unfortunately, in the present mindset, only the oil-gas sector is being continuously pampered at the cost of all others. The recent increase in gas prices—despite a reduction in the price of fuel oil/LSHS to which it is linked—is only one such manifestation of this mindset. This has to change or else, this country will be saddled with a sick and stagnant fertiliser industry.

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