

## Deregulation of naphtha — II

# Serious cost consequences

The proposed move to deregulate naphtha, and the consequent steep hike in subsidy outlay will only worsen the mismatch between fund availability and requirements, and in turn affect the fertiliser industry. Theoretically, says Uttam Gupta, subsidy is bad and increasing it at a rapid pace is "unsustainable." Therefore, orthodox economists would argue for its elimination. The only way this can be done is to remove pricing and distribution controls on fertilisers, which means the Government decides not to pay subsidy at all.

This is apparently how the policy-makers got away with the subsidy on phosphatic and potassic fertilisers when, in August 1992, they decided to decontrol these segments. This extreme step resulted in the substantially reduced consumption of P and K nutrients, increasing the N, P, K imbalance, with concomitant adverse effects on soil fertility and crop productivity.

In urea, already a subsidy level of Rs. 5,400 crores has been reached (the Budget estimate for 1995-96). With contemplated decontrol of naphtha and its huge subsidy raising effect, the policy-makers would get worked up again. They would look at increasing subsidy, but not its fundamental causes (this, incidentally includes their own actions) and come up with a sudden announcement about decontrol of urea, as they did for phosphates three years ago.

At this critical juncture, with the elections round the corner, there may not be any opposition to subsidy as no one (including the Finance Minister, Dr. Manmohan Singh) can afford to antagonise the political establishment; but it would be naive to work on the basis that subsidy will continue. After the elections, the environment can change drastically and reformers may stage a come-back, dancing to the tunes of 'no subsidy on fertilisers.'

So, when urea is decontrolled, the manufacturers would face a devastating situation. Already, farmers are paying an abysmally low price of Rs. 3,320 per tonne (thanks to politicians in not allowing any increases even when the farmers would have readily accepted modest hikes) against an industry average reasonable cost of production and distribution of about Rs. 5,500 per tonne and about Rs. 6,000 for naphtha-based plants. With naphtha decontrol and the resultant increase in prices by about Rs. 2,600 per tonne, the resultant selling price, at which the naphtha-based units can maintain their viability, will have to be about Rs. 8,600 per tonne.

In this situation, and considering that the Government will not provide any subsidy support, how can the farmers be expected to pay Rs. 5,000 per tonne more at one go? Even assuming that the Government comes back with an *ad hoc* concession (on the lines of phosphatic fertilisers), the gap is too big to be bridged. There is bound to be serious resistance

from the farmers. Lowering the price to match farmers' expectations would make almost all plants unviable.

And, this situation for the manufacturers is not because they are inefficient or their management is poor, but mainly because of Government's vacillating policy; that is, a policy that believes in no action at all for several years or resorting to extreme steps when the situation becomes unmanageable.

Already, a price has been paid for not increasing the selling price during the decade of 1980s and, yet, no lessons have been learnt even as the urea price has virtually stagnated in the 1990s. Why should not the free-market protagonists who, of late, have been talking of the virtues of 'phasing,' insist on applying this concept in fertilisers as also of rationalising the input prices particularly, of hydrocarbon feedstock.

In fact, the joint parliamentary committee (JPC) which examined the subject, recommended freezing the prices of hydrocarbon feedstock (other than gas for which 35 per cent reduction was suggested) at existing levels. It cannot be overemphasised that this, together with the increase in selling prices to farmers in small doses, is a rational approach.

This suits everybody. Farmers, because they will not be burdened with sudden and steep increase in prices. The exchequer because it saves on subsidy substantially (10 per cent increase in the urea selling price can lead to savings of about Rs. 600 crores per annum). And the industry because it is gradually moved into a situation of decontrol which will enable smooth transition without posing threat to its viability.

It may be argued that fears on account of the steep increases in naphtha price, consequent to the decontrol are exaggerated, as the industry has the option of importing under the decanalised regime. However, this option too is no less costly as, at the international prices of naphtha, the C&F landed cost works out to about \$170 per tonne or Rs. 5,800. With the Government having reportedly taken a decision to levy customs duty at 20 per cent ad valorem (now, there is no duty), the price inclusive of duty will be about Rs. 7,000 per tonne. Add to this port handling charges and the transport cost, the factory gate cost, at the bare minimum, would be about Rs. 8,000 per

tonne. Thus, even imported naphtha will cost substantially higher than about Rs. 4,500 being paid by the plants currently.

For units located in the hinterland, the factory gate cost of imported naphtha will be even more in view of the much higher cost of transportation (railway freight on movement over 1000 km and above will cost about Rs. 1,200 per tonne). Moreover, the depreciation of the rupee, of which the danger is very real, will have a further cascading effect on the cost.

Presently, at about \$ 170 per tonne C&F, the price of imported naphtha is unrealistically low; it has ruled as high as \$ 355 in the port. Considering that the international price movement of naphtha depends largely on the changing global demand-supply balance, the possibility of increases cannot be ruled out. The impact will be even greater if a major country such as India increases its purchases substantially.

Apart from the cost, a much bigger problem in adopting the import route relates to the timely availability of the material in the international market, ships for movement, handling facilities at Indian ports, infrastructure for storage and internal transportation. Considering that these are extremely weak links in the entire supply and distribution chain, the availability of imported naphtha to the fertiliser plants on a sustained basis is likely to be hampered. This would result in intermittent plant closure and consequential financial loss.

Notwithstanding the serious consequences in terms of step increases in cost, the mind-boggling subsidy-raising implications and eventual threat to the continued viability of the fertiliser industry, the Government still seems to be pursuing the deregulation of naphtha. There is no sound rationale for this except that it fits in to the overall syndrome of liberalisation.

The possibility of the so-called forces of competition exercising a moderating influence does not exist as supply of naphtha continues to be the public sector monopoly. In a country of India's size where issues of macro-economic stability and, more important, of food security, are paramount, it would be dangerous to take decisions purely on sectarian considerations. While a reasonable price should be allowed to the oil companies for ensuring the viability of refineries, it cannot be their case to charge any price they like. Deregulation of naphtha will inevitably give them such a handle and must, therefore, be avoided.

Present arrangements on the pricing and distribution of naphtha should continue and so must the supplies to the fertiliser industry at concessional rates. It must be remembered that this concession is not to the industry; instead, it is one of the potent instruments of subserving the overall objective of achieving food security in the country.

(Concluded)

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THE proposed move to de-regulate naphtha, both on pricing and distribution counts, will have an impact also on gas-based fertiliser units. For these plants, which use naphtha to fire boilers and generate power, the cost of production will increase by about Rs. 440 per tonne of urea. This is arrived at on the basis that about one million kilo calories is required to support these facilities in the urea plant and about 0.1 tonne of naphtha is needed to provide that much energy (one tonne naphtha translates into about 10 million kilo calories).

Considering that, as a matter of policy, the Government would expect all gas-based plants to use alternate fuels such as naphtha for steam generation and captive power, and taking gas-based production of about seven million tonnes, this would mean an increase in the subsidy by about Rs. 300 crores per annum. The cost of decontrolled phosphatic fertilisers, which use indigenous ammonia produced from naphtha-based units, too will go up. This in turn, will exert an upward pressure on the selling price of fertilisers to the farmers.

Already, there is mounting opposition to raising the fertiliser subsidy on account of the overall macro-economic considerations and, in particular, the need to contain the fiscal deficit. In the early 1990s, when increases in the administered prices were rampant, the allocation of funds was substantially short of the requirements.

In 1991-92, for instance, the initial Budget allocation was only Rs. 4,000 crores against the revised Budget estimate of Rs. 4,800 crores. The actual requirements were much higher, at about Rs. 6,200 crores. In 1992-93, the figures were Rs. 5,000 crores, Rs. 5,800 crores and Rs. 6,600 crores respectively. In 1993-94, the revised Budget estimate at Rs. 4,400 crores was about Rs. 900 crores more than the initial Budget provision. Likewise, in 1994-95, the revised Budget estimate, at Rs. 5,166 crores was Rs. 1,166 crores more than the provision.

Funds constraint has affected the timely release of subsidy to fertiliser manufacturers, subjecting them to financial hardships. Moreover, the blame for the increase in subsidy has been put on the industry, apparently without analysing the causes that led to it. This has led to adverse policy reorientations, further compounding the woes of the industry.

With the contemplated deregulation of naphtha which could lead to a steep increase in the subsidy component, not only will the problem of mis-match between the availability and requirement of funds get exacerbated, with its consequential effect on the industry, the pressures for more policy reorientations will mount. Theoretically, subsidy is bad and increasing subsidy at a rapid pace is "unsustainable." Therefore, orthodox economists would argue for its elimination. In reality, no magic works. The only way this can be done is to remove pricing and distribution controls, which means the Government decides not to pay subsidy at all.