PRESS BRIEF

New Pricing Policy for Urea – Stage III

There has been a substantial increase in the demand of fertilizers in last few years with urea consumption in the current year estimated to be approximately 240 lakh tones. This increase in consumption of fertilizers is expected to continue in the 11th Plan period with the demand for urea projected at 287 lakh tones in 2011-12. On the other hand, the production of urea in the country has remained stagnant during the 10th Plan period at approximately 200 lakh tones and substantial quantities of urea is being imported to ensure substantial availability of fertilizers above the assessed demand in various parts of the country. Inspite of adequate availability at macro level, there are complaints of local shortages from many parts of the country during peak consumption period. The major challenge before the Government today is to increase availability of urea within the country through enhanced indigenous production and committed joint ventures abroad for Indian market, reduction in cost of production and an effective monitoring system to ensure equitable distribution and timely availability of fertilizers to the farmers in all parts of the country.

2. With the above background, the Government has approved the pricing policy for urea units for Stage-III of New Pricing Schemes (NPS) w.e.f. 1.10.2006 to 31.3.2010. The policy has been formulated keeping in view the recommendations of the Working Group set up under the Chairmanship of Dr. Y.K. Alagh. The salient features of the proposed Stage-III Policy which is aimed at promoting further investment in the urea sector, are to maximize urea production from the Urea units including through conversion of non-gas based Units to gas, incentivising additional urea production and encourage investment in Joint Venture (JV) projects abroad. It is also aimed at establishing a more

efficient urea distribution and movement system in order to ensure availability of urea in the remotest corners of the country.

3. New Pricing Scheme (NPS) for urea was introduced w.e.f. 1st April, 2003. The Stage-I of NPS was of one year duration from 1st April, 2003 to 31st March, 2004 and Stage-II was of two year duration from 18th April to 31st March, 2006. With the Stage-III of NPS being implemented w.e.f. 1st October, 2006, the Stage-II of NPS stands extended upto 31st September, 2006.

4. The Stage-III policy seeks to promote usage of most efficient and comparatively cheaper feed stock natural gas/LNG for production of urea in the country. The policy lays down a definite plan for conversion of all non-gas based urea units to gas. At present, there are 9 urea units (MFL,SPIC, ZIL, MCFL, SFC, GNFC, NFL-Nangal, NFL-Bhatinda, NFL-Panipat) in the country which are based on naphtha or FO/LSHS as feed stock. All these 9 units are required to switch over to natural gas/LNG within a period of next three years. Beyond this time limit, the high cost urea produced by these non-gas based units will not be entitled to subsidy at the existing levels and it will be restricted to import parity price of urea. The units, which are unable to tie up gas will have to explore alternative feedstocks like Coal Bed Methane (CBM) and coal gas.

5. The availability of gas is critical to the growth of urea industry in the country. Presently, the indigenous availability is not sufficient to meet the demand of existing gas based urea units in the country. To this end, the Department of Fertilizers constituted a Committee under the chairmanship of Secretary(P&NG) with Secretary(Fertilizers), Secretary(Expenditure), Secretary(Planning Commission) as its members to deliberate upon various issues relating to connectivity and assured supply of gas to the fertilizer sector. The Committee will also develop an appropriate mechanism for fixing the price of the gas in a transparent manner. It is expected that the availability of gas in the country will improve from 2008-09 onwards and the new policy, taking into

account the above fact, has laid down specific timelines for conversion of all non-gas based units in the country to gas.

6. In order to incentivise conversion of non gas based units to gas, the policy **provides for a regime where there will be no mopping up of energy efficiency for a fixed period of five years for naphtha based as well as FO/LSHS based units.** The policy also recognizes the comparative higher cost of conversion of FO/LSHS based units to gas and provides for one time capital investment assistance to these units for conversion to gas during the next three years. A specific policy to this effect will be announced separately by the Government.

7. The policy also lays down a formulation to dis-incentivise high cost production from the non-gas based units and to facilitate their early conversion to gas. It is proposed that these units may be allowed to produce 100% of capacity should they adhere to an agreed timetable for conversion to Gas and tie up requisite Gas/CBM/Coal gas. If they do not, they will be given only 75% of the fixed costs beyond 93% of capacity utilization in the 1st year (1.4.2007) and 50% of the fixed cost beyond 93% capacity utilization from 2nd year (1.4.2008) onwards.

8. Considering the likely growth in consumption of urea in the years to come, the policy seeks to encourage the existing urea units to produce beyond 100% of their installed capacities by introducing a system of incentives for additional urea production subject to merit order procurement. The policy of requiring prior Government permission for additional urea production has been dispensed with. All production between 100% and 110% of the existing reassessed capacity will be incentivised on the existing net gain sharing formula between the Government and the unit in the ratio of 65:35 respectively with the proviso that the total amount paid to the units after including the component of variable cost will be capped at the units own concession rate. The units increasing production beyond 110% will be compensated at their concession rate subject to the over all

cap of Import Parity Price (IPP). To the extent Government does not require any quantities of additional production, the urea companies would be free to dispose of the remaining quantities by way of export or sale to complex manufacturers without any permission. The policy also encourages setting up of Joint Venture projects abroad where gas is readily available at reasonable prices. It recognizes our heavy dependence on imported raw materials/intermediates and feedstock in the fertilizer sector and to properly leverage this position, the policy seeks to create specialized agency to coordinate investments abroad in fertilizer sector.

9. The policy seeks to rationalize distribution and movement of urea and the system of freight reimbursement with the objective of ensuring availability of urea in all parts of the country. The Government will continue to regulate movement of urea up to 50% of production depending upon the exigency of the situation. The State Governments will be required to allocate the entire quantity of planned urea arrivals including both regulated and de-regulated urea in districtwise, mouthwise and supplierwise format. The units will be required to maintain a district level stock point and the subsidy will be paid only when the urea reaches the district. The monitoring of movement and distribution of urea throughout the country up to the district level will be done by an On line Web based monitoring system. To facilitate movement of fertilizers to far flung area, the reimbursement of freight will be based on actual leads for rail and road movement. The rail freight will be reimbursed as per the actual expenditure and the road freight will be escalated as per composite road transport index every year. One time enhancement of 33% will be granted on the road component of primary freight to offset the impact of Supreme Court directive regarding maximum truck load limit of 9 MT on road vehicles. The existing special freight subsidy scheme will continue for supply of urea to the North Eastern States except Assam and Jammu & Kashmir. In addition, the Department will operate a buffer stock through the state institutional agencies/fertilizer companies in major urea consuming States up to a limit of 5% of the seasonal requirement.

10. The Stage-III of NPS seeks to carry on the existing 6 group classification of urea manufacturing units in the country with updation of all costs upto 31st March, 2003. The respective pre-set energy consumption norm of each urea units during Stage-II of NPS or the actual energy consumption achieved during the year 2003, whichever is lower, will be recognized as the norm for Stage-III of NPS. The policy also provides for updation of costs on account of cost of bags through 3 year moving weighted average cost of bags to compensate for the rise in prices for the last three years. It also provides for payment of sales tax on input and other taxes recognized under erstwhile Retention Price Scheme, on actual basis.

11. NPS Stage-III seeks to take forward the principles of uniformity and efficiency in urea production as enunciated during Stage I and II of NPS and also aims at bringing in more transparency in distribution of fertilizers across the country. It is expected that the policy will encourage increase in indigenous production from the existing urea units in the country and facilitate early conversion of non-gas based units to gas leading to substantial savings in subsidy. It is also expected that with the launch of Fertilizer Monitoring System (FMS) to monitor movement of fertilizers upto district-level and the freight rationalization proposed in the new policy, the distribution of fertilizers in remote corners of the country will improve considerably without any complaints of shortages in future. The Department of Fertilizers will continue its endeavour to promote the growth of fertilizer industry in the country and ensure adequate availability of fertilizers to the farmers.

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