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A flawed approach to fertiliser subsidy

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In the Union Budget for 2000-01, finance minister Yashwant Sinha stated that much of fertiliser subsidy goes to producers and not to farmers. Similar sentiments were recently expressed by the prime minister when he said that benefit of fertiliser subsidy goes more to factories than to farmers.

The above observations are based on studies which use farmgate cost of supplying imported fertilisers (C&F price plus handling and distribution cost) as benchmark.

The world market price depends on global demand-supply balance in which India and China play a major role. In fact, in the 90s their share in urea imports varied between 29 per cent to 46 per cent. Thus, when their share was high, viz., 1991-92 and 1995-96, average C&F price in India was about US $189.0 and US $225 per tonne respectively. As against this, in 1997-98 and 1998-99 when their share declined significantly, average C&F price in India reduced to about US $151.0 per tonne and US $100.4 per tonne respectively.

Clearly, under import parity price theory, there have been situations of both subsidy to domestic producers — as in 80s and recent years in 90s — as well as tax as in major part of 90s. It is pertinent to note that during 70s also, a cess known as fertiliser pool equalisation charge (FPEC) was collected from domestic producers (their cost of supply being lower than selling price) to cross subsidise higher cost of imports.

Using import parity concept to determine who is being subsidised and to what extent is seriously flawed. When, the benchmark itself fluctuates violently, how can this be a credible basis? All the more so, when imports by India heavily influence this! Even under this flawed approach, economists have tended to play up the scenario of subsidy ignoring reverse situations of tax on industry. Unfortunately, even FM/PM have joined the bandwagon as would be clear from above statements.

The existing mind-set is pregnant with dangerous possibilities. The obsession with cheap imports could deflect our attention from self-sufficiency in fertilisers. And, once India starts importing significant quantities, international prices will increase sharply. Even at 2.0-2.5 million tonnes, as was the position in 1996-97 and 1997-98, C&F price could be in range of US $180-200 per tonne.

With contemplated changes involving replacement of existing system by uniform pricing — as per recommendation of HPC (1998) or any other variant — or total decontrol (hinted in FM's Budget speech), we can be in for much greater loss of domestic production. In fact, unless adequate care is taken, about 8.0 million tonne urea capacity locked in naphtha and fuel oil based plants will not be available. In such a scenario, our dependence on imports would be unprecedented.

In turn, this would lead to skyrocketing prices in world market as was the position in the 70s when we paid a high of US $300 per tonne C&F. At these levels, even though, under import parity benchmarking, plants (perceived as high cost on current prices) would appear to be low cost, but they will simply not be in existence to give country much needed supplies.

The need of the hour is to take a balanced and pragmatic view. Comparing domestic costs with import price is misleading. It should be avoided. Comparison with production cost in exporting countries is also not on all fours as feedstock there is available to plants at less than US $1 per million Btu as against much higher prices in India — 2-3 times for plants along HBJ and 7-8 times for naphtha based plants. Even cost of capital in latter is almost twice the former.

Considering vital role of fertilisers in increasing production of foodgrains and therefore, its inextricable linkage with food security, any decision in regard to supporting domestic production capability — existing as well as future additions — has to be strategic.

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