THE HINDUSTAN TIMES NEW DELHI MONDAY APRIL 17, 2000

Charting a new course in fertilizers policy

Uttam Gupta

THE IMPACT of the budget for 2000-01 on the fertilizers sector in India is assessed — in the following paragraphs — with reference to the fertilizers subsidy scenario, imbalance in fertilizer use, policy environment and profitability prospects of fertilizer companies.

On subsidy, the budgetary allocation for subsidy on domestic urea for 1999-2000 was Rs 8,000 crore. The likely requirement is about Rs 10,000 crore (this includes about Rs 2,000 crore due to steep increase in hydrocarbon prices and over Rs 1,000 crore due to revision in conversion charges for 1997-98 and 1998-99). Against this, the revised estimate is Rs 8,670 crore.

For 2000-01, the budgetary allocation is Rs 8,058 crore. The selling price of urea has been increased by 15 per cent. While this would yield a saving of about Rs 1,200 crore, the allocation will still fall substantially short of the likely requirement. In particular, throwforward from the current year, i.e., about Rs 1,300 crore plus some further payments due to revision in conversion charges for 1999-2000, will remain uncovered.

In respect of decontrolled P and K fertilizers, the revised estimate for concession support during 1999-2000 is Rs 4,500 crore (same as the budgetary allocation). Against this the likely requirement is about Rs 6,000 crore. For 2000-01 the allocation is Rs 4,093 crore. Despite savings of about Rs 800 crore due to increase in selling price of DAP and MOP by 7 per cent and 15 per cent, respectively, this will fall significantly short of likely requirements.

The substantial shortfall in availability of funds vis-a-vis requirements during 1999-2000 and 2000-01 point towards the possibility of significant reduction in retention price consequent to rationalization in RPS proposed in the finance minister's budget speech. The reduction in allocation for the 2000 *kharif* season to a specified percentage of optimum production is also aimed at reducing payments to producers. In the P and K sector also, significant reduction in concession rates have been hinted in the finance minister's speech.

Fertilizer use has remained unbalanced ever since the sudden decontrol of all P and K fertilizers in August, 1992 which led to sharp increase in their prices even as the price of urea — under control all through — moved at a slow pace. From 5.9:2.4:1 in 1991-92, the NPK use ratio had worsened to 8.5:2.5:1 during 1995-96. It improved in 1998-99 to 8.5:2.9:1. The increase in urea price in the 2000-01 budget will not make a dent on imbalance as prices of DAP and MOP have also been correspondingly raised.

All through the 1990s both the controlled (urea) and decontrolled (P&K) sectors have been gripped by uncertainties of policy environment. Whereas in the latter the scheme of concession support is devoid of stability (it automatically lapses at the yearend and has to be revived through a fresh order) apart from distortions in implementation, in regard to former there has been a question mark on RPS for a bit too long. This has affected investment and pace of addition to capacity.

The setting up of a high-powered committee on fertilizers in January, 1997 had raised some hopes. The committee submitted its report in April, 1998. Even almost two years later a long-term and stable policy eludes the industry. The finance minister, in his budget speech, has stated that the "ministry of chemicals and fertilizers will bring out son a road map for phasing out the RPS in the medium term". This is a clear pointer to eventual dismantling of the RPS. An early announcement of the detailed plan of action is needed to clear uncertainty and restore investor confidence.

The bottomlines of fertilizer corporates are likely to come under stress due to inadequate budgetary allocation on one hand and contemplated reduction in retention price/concession support on the other. Specifically, capping of the capital related charges (CRC) has been indicated. In a postbudget discussion on TV, the expenditure secretary hinted at putting a ceiling of 100 per cent of assessed capacity. Apart from preventing optimum utilization of capacity, this would affect margins due to various disallowances under pricing.

The budget has raised countervailing duty (CVD) on fertilizer project imports as well as imports for revamp/renovation/modernization of existing plants from 10 per cent to 16 per cent even as all other duties, viz., basic rate, surcharge and special additional duty (SAD), applicable to revamp/renovation, have been retained at existing levels. This will result in increase in effective import duty from 16.05 per cent to 22.38 per cent for new projects and from 20.05 per cent to 26.38 per cent for revamp/renovation projects.

The above will make setting up of new projects as well as revamp/renovation/modernization of existing plants more expensive. In turn this would lead to a higher subsidy bill if existing dispensation of control/subsidy continues. In the regime of decontrol and no subsidy, this would seriously hamper the viability of these projects.

The rationalization of excise duty structure has by and large not affected the feedstock used in production of fertilizers. Thus, use of naphtha for both feed and nonfeed continues to attract nil duty. The use of FO/LSHS as feed will also attract nil rate. However, on the use of FO/LSHS other than feed, duty has been increased from 8 per cent to 16 per cent. This will raise production cost and, in turn, put pressure on margins under the eventually liberalized regime.

To conclude, the proposed increase in selling price of urea is a step in the right direction. Apart from yielding significant savings in subsidy, it will help in reducing the current yawning gap between reasonable cost of supply on one hand and realization from sale on the other. However, there is an urgent need to check spiraling prices of inputs, particularly feedstock, as this alone will make a dent on the subsidy bill besides facilitating a smooth transition to eventual decontrol.

The other measures relating to subsidy allocation, increase in CVD on fertilizer project imports and imports for renovation, expansion and modernization of existing plants, reduction in concession on DAP and MOP and capping of CRC — besides increase in railroad freight on movement of decontrolled P and K fertilizers — would adversely affect the continued health and growth of the industry.

(Uttam Gupta is chief economist at the Fertilizer Association of India, New Delhi)