JULY 27, 1998 THE HINDUSTAN TIMES

Fertilizer industry- a scapegoat for rising subsidy

By Uttam Gupta

IN the debate on fertiliser subsidy, invariably, a question is raised as to whom the subsidy money goes and who gets how much? In this context, the persons who immediately come to mind are: (i) the producers of fertilisers, and (ii) consumers of fertilisers.

At the outset, we need to know as to how the system of paying subsidy works. Consider the case of urea, a premier nitrogenous fertiliser which accounts for about 82 per cent of nitrogen consumption and about 75 per cent of total subsidy on fertilisers.

The selling price of urea is controlled at a low level — currently, Rs 3,660 per tonne — to induce increase in its consumption and enable production of foodgrains and other agricultural products at low cost. In a world of inflation, reasonable cost of production is higher than net back to producer from selling at controlled price. The difference is reimbursed as subsidy under the retention pricing scheme (RPS).

Under RPS, each unit gets a fair price determined on the basis of prescribed efficiency norms. The price varies from unit to unit due to differences in feedstock, location, vintage, etc. On a weighted average basis, cost of supplying domestic urea to farmers is currently about Rs 7,500 per tonne. Thus, in pure financial terms, subsidy is Rs 3,840 per tonne (7500-3660).

A portion of urea demand is met from imports. The excess of C&F landed cost plus handling and distribution cost over the selling price is subsidy on imported urea. Currently, at about $110 per tonne, former works out to about Rs 6,500 per tonne resulting in subsidy outgo of Rs 2,840 per tonne (6500-3660).

The relevant subsidy rates multiplied by quantum of production/imports give the aggregate subsidy. This is paid from the Union Budget. During 1997-98, this was Rs 6,600 crore on indigenous urea and Rs 826 crore on imported urea. For 1998-99, these are budgeted at Rs 7,600 crore and Rs 983 crore, respectively.

On the face of it, subsidy accrues to the farmer; for if selling price had not been controlled, he would have to pay full reasonable cost of supply. Subsidy provides the buffer and helps in maintaining the price to him at a low level.

But, the farmers may argue that if they were to pay more for fertilisers, this would have increased the cost of producing foodgrains. The low price of former helps in keeping the cost of latter low. Hence, it is subsidy to consumers of foodgrains.

On economic logic, things will look different. The premise here is that imports represent true cost of supplying urea. Currently, this is Rs 6,500 per tonne. Thus, with farmer paying Rs 3,660 per tonne, subsidy to him is Rs 2,840 per tonne. However, since domestic supplies cost Rs 1,000 per tonne more than cost of imported urea, industry is also subsidised by that much.

This approach is fundamentally flawed. It assumes that world market is a huge pool of urea and it is possible to import unlimited quantities at a given price. This is factually incorrect. There can be supply constraints and imports by big players like India and China result in sharp increase in price as happened in 1995-96/1996-97 and on several other occasions in the past.

During 1995-96, at about $240 per tonne C&F, farmgate cost of imported urea was about Rs 10,000 per tonne. Thus, even as price to farmer was only Rs 3,320 per tonne, subsidy to him would be Rs 6,680 per tonne. However, since domestic supply cost only about Rs 6,000 per tonne, on above logic, it was taxed to the tune of Rs 4,000 per tonne.

So, who is subsidised and how much? According to economic criterion, the result would be different depending on the point of time. At times, indigenous industry would appear to be subsidised — as of now — whereas, on many other occasions, it would be taxed, at times heavily.

With international price of urea fluctuating from year to year and even within any given year, on a month to month basis — perhaps, at times on a daily basis — using cost of imported urea as a benchmark for determining who is subsidised and how much, will not serve any useful purpose.

It cannot also be the basis for deciding the price to be paid by farmers and realised by producers. In such a scenario, while, it is virtually impossible for former to plan crop production, even latter cannot maintain assured and uninterrupted supplies. Even the high-powered Hanumantha Rao Committee has not favoured this.

That subsidy helps in sustaining low and stable price to farmers and, in turn, keeping cost of food low is sound logic. The industry is only a conduit/channel for ease of administration, keeping cost of administration low and preventing misuse. Merely on this basis, to argue that subsidy is cornered by industry does not make sense.

What can the Government do to get rid of subsidy? It could remove controls, dismantle RPS and with it, subsidy support. The producers will then sell urea at market determined price. This is bound to be much higher than present low of Rs 3,660 per tonne as even cost of imported urea is Rs 6,500 per tonne despite current depressed C&F level.

If, then, the Government wishes to protect farmers, it will have to make its own arrangements to buy fertilisers from producers (or import) and sell at low price; like it does in foodgrains sector. Subsidy will still have to be given, but, this time directly, covering millions of farmers with attendant problems of high cost and misuse.

The producers whose cost is higher than net back at the market price — primarily new units and those using costly feedstock viz., naphtha/FO — will become unviable.

The Government will have to work out suitable packages for support, e.g. one-time capital subsidy/reimbursement for differential feedstock cost. This is to ensure that efficiently operated plants are not penalised and country does not lose huge output.

The units having cost lower than market price — mainly old/depreciated gas based plants — will gain. Whether or not, they will invest the gains for expansion/growth, will depend on how likely cost then fairs in relation to market price. Likewise, fresh investment will depend on assessed viability in a market based system.

The Government could proceed on the above basis if it believes that time is ripe to strike now, and that transition can be managed without compromising on country's food security. But, so long as it controls selling price at an artificially low level, it is duty bound to guarantee to producers their reasonable cost of production in full.

An attempt to deny difference between reasonable cost and price — even partially — would be totally illogical and unfair. Nor, will it be proper to find a scapegoat in the industry for all the ills that go with rising subsidy.

(The author is the chief economist of Fertiliser Association of India.)