THE HINDUSTAN TIMES

26 MAY, 1997, MONDAY

Fertiliser policy – unkind to domestic industry

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IN the matter of price realisation for their crops, the Indian farmers are invariably at a disadvantage vis-a-vis their counter-parts in the major exporting countires. Recently, in respect of wheat, they tried to get a price comparable to the cost of import, i.e., about Rs 650 per quintal, but, had to remain content with Rs 475 per quintal. Whether or not farmer's demand was justified is a debatable point, but, one thing comes out quite clearly: While, the Government would not mind spending heavily on imports, it does not take kindly to the domestic producers.

The inherent dislike for domestic producers extends to fertilisers as well. Fertilisers are basic inputs in production of foodgrains and other agricultural crops. Consequently, the continued health and growth of the domestic fertiliser industry is vital to food security. In the late 70s, and 80s, the Government pursued policies which helped in meeting increasing demand for fertilisers predominantly from domestic production. In fact, the Sixth and the Seventh Plan documents emphasised on near self-sufficiency in nitrogen production with only 1 million tonne to be met through imports.

The epicenter of these policies was the retention pricing and subsidy scheme (RPS) which ensured an attractive return to the producers despite control on the selling price to the farmers at a low level to induce increasing consumption. This led to a increase in the installed capacity of nitrogen from 4.58 million tonnes in 1980-81 to 8.28 million tonnes during 1991-92. Production increased even faster from 2.16 million tonnes to 7.3 million tonnes. During 1991-92, thus, indigenous production met about 90 per cent of the consumption, the latter being 8.0 million tonnes.

Towards the end of the 80s, however, our policy makers developed a dislike for domestic production. The trigger point was the infamous Varadarajan committee report, in 1987, which advocated the make vs buy option with emphasis on the latter to meet the increasing demand. During 1986-87, the C&F landed cost of imported urea was US $ 100 per tonne leading to farmgate cost of about Rs 2,300 per tonne. As against this, the cost of domestic supply, on an average, was about Rs 3,700 per tonne. When imports were coming cheap why subsidise high cost domestic production, the Committee argued.

The Government responded by tinkering with the RPC. Beginning 1-4-1988, the depreciation and capacity uuilisation norms were tightened. While, the former was reduced from 10.56 per cent to 6.33 per cent, the latter was raised from 80 per cent to 90 per cent for gas based ammonia plants and 85 per cent for naphtha/fuel oil based plants. Consumption norms for raw materials and utilities changed on the basis of actuals achieved in the previous pricing period. Various legitimate elements of cost were either disallowed or short paid and payment of escalation claims including normal subsidy payments delayed.

All this made investment unattractive leading to a substantial slow down in growth during the 90s. The addition to 'N' capacity upto October 1996, was only 1.3 million tonnes. This has come about from commissioning of Nagarjuna, Chambal, Babrala and Shahajahanpur on which investment decisions were taken in the 80s. Due to this and the consequential inability of domestic production to keep pace with rising demand, urea imports increased from nil in 1990-91 to 391 thousand tonnes in 1991-92, 1.86 million tonnes in 1992-93, 2.84 million tonnes in 1993-94, 2.88 million tonnes in 1994-95, 3.76 million tonnes in 1995-96 and 2.7 million tonnes during 1996-97.

Imports were encouraged ostensibly to save on subsidy outgo. Has the Government achieved this objective? The answer is a categorical 'No'. From the table, it may be seen that except in 1993-94, in all other years, the farmgate cost of imported urea has been higher than the cost of domestic urea. Even as the farmer pays a uniform price, the former has thus, entailed a much higher level of subsidy than the latter.

FARMGATE COST OF INDIGENOUS AND IMPORTED UREA

Year	(Rs./tonne) Indigenous	Imported
1991-92	4554	5758
1992-93	5008	5752
1993-94	5445	4843
1994-95	5686	6738
1995-96	5851	8740
1996-97	6093	8610

The Committee erred and so did the Government, in presuming that the imported material will continue to come cheap. The International price of urea fluctuates very widely. This depends mainly on the global demand supply situation in which the bulk of the supplies are from FSU countries including Russia and the Middle East whereas, the demand is mainly from China and India.

Changes in the C&F landed cost of imported urea has closely followed the trends in the quantum of imports by India even as imports by China have been more or less steady. That the cost had reached a low of US $100 per tonne during 1986-87 was, to a great extent, the result of substantial reduction in imports by India consequent to increase in domestic production. During 1987-88 and 1988-89, despite continued decline in imports by India, the price continued to increase mainly because of heavy imports by China.

Thereafter, prices declined up to 1993-94, mainly due to substantial surplus from the FSU countries in the wake of steep decline in their internal consumption as a result of market oriented policies involving removal of fertiliser subsidies. Since 1994-95, the prices firmed up again reaching a high of US $ 240-245 per tonne during 1995-96 due to India increasing its imports to 3.7 million tonnes. Clearly, we paid more for import due to neglect of domestic production leading to increased import dependence and resultant higher prices.

Even now, the lesson has not been taken. According to a recent Study on Restructuring Fertiliser Policies commissioned by the Ministry of Finance, the C&F landed cost of imported urea will rule in the range of US $140-160 per tonne in the long-run. This again, is an extremely shortsighted view. The likely trends in the global demand-supply balance indicate that far from reduction over the existing levels, i.e., about US $ 180 per tonne, the prices would firm up.

According to available projections by World Bank/FAO/UNIDO Fertiliser Industry Working Group (1996), the global nitrogen surplus is expected to decline from 2.89 million tonnes in 1995-96 to 1.27 million tonnes by 1999-2000. The exportable surplus from the FSU countries including Russia from whom India imports bulk of its requirements, is slated to go down from 2.9 million tonnes to 2.6 million tonnes.

The plants contributing to exportable surplus in FSU countries were set up in the 70s. These would require heavy investment in revamping/replacement and modernisation for sustaining the persent level of production. Besides, there is an increasing trend in the gas price and this will gain momentum leading to a higher cost of production. The price expectations of this region are thus, bound to be higher to ensure the viability of plants out of export realisation.

In the Middle East, — another major supplier to India — due to abundance of gas and prevailing low gas price, low cost product would be available from the existing plants. From the Indian side, there will be freight advantage as well; but, that does not automatically mean that we will get this urea cheap. This is because Middle East suppliers insist on higher FOB realisation, thus, more or less offsetting the potential freight benefit. Moreover, in a tight global supply situation, Middle East producers will not desist from taking advantage.

For upcoming projects in the Middle East including the Oman JV in which RCF/KRIBHCO are partners, the investment cost will be higher mainly due to higher fabrication charges. Besides, the possibility of increase in gas prices of new projects is also not ruled out. This will inevitably make future supplies from the Middle East costlier.

The impact of the exchange rate cannot be brushed aside. Even at the low of US $ 160 per tonne projected by the Group and assuming that the Rupee does not depreciate further, the farmgate cost of imported urea would be about Rs 7,000 per tonne against the cost of indigenous urea of about Rs 6,000 per tonne. Our BOP continues to be fragile due to heavy oil, POL and other essential imports. Hence, the Rupee will only weaken leading to still higher cost of imported urea to the farmers.

He cannot also wish away the constraints of infrastructure particularly at ports and for inland movement of the material to the consumption points. During 1995-96, when urea imports were 3.7 million tonnes and DAP import was at 1.4 million tonnes, serious problems were faced regarding handling at the ports as well as in timely arrangements of wagons for movement to consumption points. Such problems could reach mind boggling proportions in the event of urea imports on a still larger scale.

Increasing fertiliser needs to support the required increase in foodgrains production can be met, on a sustained basis, only by ensuring the health and growth of the domestic industry. To realise this goal, the policy makers should shed their contempt for domestic industry and work for evolving a conducive pricing policy environment.

The present distortions have led to a situation whereby despite operating at high capacity utilisation — well above 100 per cent — the units are no where near the 12 per cent post-tax return allowed under the RPS. At normative levels, the return would have been still lower and some even made losses.

Continuation of these distortions or any further step which takes away the incentive for doing better, e.g., contemplated move to deny capital servicing charges above 110 per cent capacity utilisation, would threaten the vaibility of existing units and discourage fresh investment. Reportedly, the Tata Chemicals has put its contemplated expansion plan at Babrala in cold storage and many others might follow suit.

A long-term fertiliser policy — preferably for 15-20 years — which provides attractive return to the producers and, at the same time, enables rapid and sustained increase in consumption, brooks no further delay. If the RPS with suitable modifications meet the objective, then, the Government should clearly commit itself to its continuation. If, however, it is felt that it has outlived its utility, then a new policy may be phased in avoiding any dislocation. The Hanumantha Rao Committee should address this fundamental task.

At 12 per cent post-tax and taking the prevailing corporate tax of 35 per cent, the pre-tax return presently allowed works to only 18.46 per cent. This is totally unattractive considering the much higher return in other sectors and even investment in fixed deposit of good rated companies including PSUs like SAIL, NTPC fetching 14.5-15.5 per cent from day one. The recent ICICI Bond issue carries 17.5 per cent. The policy should provide for a return which covers the cost of capital plus a reasonable margin towards risk.

Due to the absence of a rational feedstock policy, there is no gas for new fertiliser projects. Even naphtha, the next best feedstock, is not available at a concessional price. Although, its import is allowed, the cost is prohibitive — at prevailing rate it is about Rs 3,000 per tonnes — higher than domestic naphtha. A rational feedstock policy which ensures supply of gas and naphtha to the fertiliser industry on top priority and at a reasonable price — as in the 80s — should be urgently announced.