THE ECONOMIC TIMES
August 16, 1988

FERTILISERS

Control v decontrol

The problem of excess fertiliser availability and high stocks needs to be disentangled from the avoidable controversy of controls versus no controls. In any case, removal of controls is no panacea for the industry's problems of burgeoning stocks.

By Uttam Gupta

Recent reports regarding removal of restriction on movement of fertilisers have evoked mixed reaction from different quarters. The spontaneous response has been that this would enable the industry clear the burgeoning stocks (over four million tonnes as on 1.4.1988) and consequently give relief by way of reduced carrying cost, better cash flow and, perhaps, speedy return of normal market conditions.

Protagonists of free market interpret the removal of curbs as a precursor to a totally liberalised regime which besides forcing manufacturers to develop markets in areas hitherto left uncovered, would also save the already beleaguered treasury from the burden of fertiliser subsidy to a certain extent.

The contemplated move indeed constitutes a far-reaching step particularly when viewed against the backdrop of nearly one and a half decades of controlled regime since 1973 when the Fertiliser Movement Control Order (FCO) was promulgated bringing supply and distribution of fertilisers within the purview of the Essential Commodity Act (ECA). It assumes added significance in the context of close integration of such controls with statutory regulation of consumer price of fertilisers and coterminus with that, the administration of Retention Price Scheme (RPS) involving payment of subsidy by the government owing to higher cost of production as also transportation. Obviously, removal of distribution controls cannot be treated in isolation from price controls.

The moot question is whether the liberalisation, in part or full, will help in dealing with the immediate problem of excess stocks. More important, however, is whether decontrol could prove to be a better alternative than the present dispensation of controls under the ECA. Let us examine our immediate concernfirst. The genesis of the problem lies in sagging demand which in the drought situation, was symptomatic of almost all parts of the country causing excess availability all over. Consequently, the remedy lies in refurbishing demand which to a large extent, is dependent on the weather factor. The latter determines prospects of fertiliser use not only in rainfed areas constituting 70 per cent of cultivated land, but also irrigated areas susceptible to rainfall pattern to a great extent indirectly. Fortunately, south-west monsoon has done well with even some of the chronically drought areas such as Gujarat and Rajasthan in the past, getting reasonably good rainfall. All this has a good potential for revival of demand during the current year. It needs to be clarified that removal of restrictions is relevant only in a situation where some pockets have surpluses while others are deficit, which is surely not the case in the contemporary market scenario.

Far from providing relief to the industry in the present difficult situation, this somewhat hasty change of policy can prove to be highly damaging. First, the fertiliser market is well on its way to recovery insofar price discipline is concerned.

This is indeed a creditable achievement particularly against the backdrop of continuing excess availability situation and non-reimbursement of the excess inventory carrying cost. In this situation, otherwise full of promise, free movement of the un-allocated material may re-kindle the price war as attempts are made to off-load the same in a market which is not yet fully prepared to take it. Needless to mention even the orderly distribution of the allocated material under the ECA, may get disrupted by unrestrained invasion of this free material in the market.

Second, the freedom of distribution will inevitably lead to criss-cross movement of fertilisers as in the absence of any regulation, the tendency will be to concentrate on areas wherein besides the existence of adequate demand, selling conditions are relatively easier. In this context, it needs to be emphasised that one of the basic objectives of controls under ECA has been to avoid criss-cross movement of fertilisers consistent with optimisation of freight cost and reducing burden on the country's limited transport infrastructure in particular, the railways.

Third, the stipulation that the additional cost incurred in movement of the free material will not be reimbursed together with the consumer price being statutorily fixed on FOR basis would mean that manufacturers will tend to supply the material to places nearer the factories in a bid to minimise erosion in profitability which is inevitable in a situation of retention price also being fixed exclusive of freight cost. In the process, the remote and inaccessible areas will tend to get neglected thus militating against balanced regional growth of fertiliser use. It is important to note that under the ECA, this aspect is well taken care as allotments are made on the basis of a rational distribution plan covering fertiliser needs in every nook and corner of the country.

Fourth, even within the industry there will be serious distortions with different units getting differentially affected by the proposed change. Under the RPS, units are receiving varying fair ex-factory prices depending on the capital cost, feedstock and process technology.

Such a distortion may lead to unhealthy competition among units which besides causing stultified growth, would also thwart the process of restoring market discipline.

Finally, it needs to be recognised that distribution controls are only one of the constituents of an integrated package the government has adopted in pursuit of its overall policy of promoting increase in fertiliser consumption consistent with rapid agricultural growth. The other vital aspect is a control on the price of fertiliser which is statutorily fixed at a low level and is the same throughout the country subject only to local taxes being a state subject under the Constitution. This also involves payment of subsidy by the government as the price thus fixed is reasonably low considering the capacity of the farmer to afford and is, therefore, unrelated to the cost of production which is higher even at efficient levels of operation. The subsidy from the government which is ultimately aimed at ensuring cheap food for the population, is best put to use by regulating supply and distribution of fertiliser presently achieved by operating the ECA system, the prime objective being to meet the legitimate needs of all parts of the country. Removal of restrictions on movement would frustrate this objective and is in effect tantamount to improper use of subsidy.

Whether removal of both price and distribution controls is a desirable course entailing, as it would, no subsidy burden on the exchequer whether by way of reimbursement of transport cost or subsidy support to the extent of the difference between the reasonable cost of production and the price to the farmer is debatable. The likely consequences of such a move need to be assessed before preparing ourselves to move into this territory, perhaps, not chartered even by the advocates of the free market economy themselves including the US, Japan and EEC.

In the absence of any control, the price to the farmer will have to rise steeply to cover reasonable cost of production at efficient levels of operation plus transport cost. Under the present dispensation, this is taken care of by fixation of retention price and reasonable equated freight. In the case of urea for instance, the price to the farmer will have to increase by at least Rs. 1000 per tonne leading to substantial decline in fertiliser consumption. Increasing the procurement price of agricultural produce to set off the higher fertiliser price would not help for two reasons.

First, the majority of small and marginal farmers who produce food for self consumption will be left unprotected. The farmers located far away in inaccessible and hilly areas in particular, will be most seriously hurt as the price to be paid by them, will have to be intolerably high owing to the impact of much higher transportation cost. The emerging situation will not only run contrary to the government's policy of promoting balanced regional growth, but also, constitute a bottleneck in maintaining the momentum of increase in foodgrains production which can be sustained only by exploiting the potential in rainfed areas requiring unprecedented logistic support in terms of transportation, warehousing, handling and dealer development etc.

Second, even in respect of farmers producing marketable surplus, increase in procurement price to maintain the economics of fertiliser use, will lead to a steep increase in the consumer price of foodgrains which apart from triggering inflation at an accelerating pace would straightaway hit the masses living below the poverty line thus constituting a potential threat leading to socio-economic destabilisation.

In case, it is decided to keep consumers immune by maintaining issue prices from the Public Distribution System (PDS) at the same level, the government will have to give higher foodgrain subsidy, thus frustrating the objective of removing control on fertilisers.

Within the industry also, the plants which are high cost entirely due to factors beyond their control such as a recently commissioned unit entailing high capital cost or a unit paying more for purchased inputs such as power etc., owing to the sheer factor of location, will be at a substantial disadvantage vis-a-vis plants which are low cost purely on account of benefit of adventitious location. Also, no further investment will be attracted in this industry as prospective entrepreneurs will assess bleak prospects of demand for their product at a price substantially higher than the level the Indian farmer has been paying all through. In short, a free market regime will be detrimental to the national interest as it will scuttle the growth of the industry besides jeopardising continued growth of agriculture owing to reduced fertiliser consumption.

To conclude, the problem of excess availability and high stocks needs to be disentangled from the avoidable controversy of controls versus no controls. In any case, removal of controls is no panacea for the industry's problems of burgeoning stocks. It has to be attacked right at its roots. A beginning has already been made with the government virtually not importing fertilisers during latter half of 1986-87 and 1987-88 (barring negligible quantities under contractural agreements), a freeze on imported stocks w.e.f. 1.4.1987 continuing into the current year and finally no plans to import urea during 1988-89.