Implications of customs/excise duty rationalization on fertilizer industry

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THE DRASTIC rationalization of the structure of customs and excise duties in the budget for 1999-2000 will have far reaching implications for the fertilizer industry and subsidy outgo from the exchequer.

The customs duty on fertilizer project imports has been raised from zero to a basic rate of 5 per cent ad valorem. In addition, it will attract a surcharge of 10 per cent. Inclusive of this the effective rate of duty will be to 5.5 per cent. Besides, project imports will also attract countervailing duty (CVD) of 10 per cent. With this, the net impact will be 16.05 per cent.

The duty on import of plant/machinery, used for renovation and modernization of existing fertilizer plants, will also increase from the existing nil to 5 per cent plus surcharge @ 10 per cent plus CVD @ 10 per cent. The net incidence will thus be 16.05 per cent.

The import of urea for use as manure, DAP for use as manure or for production of complex fertilizers and MOP for for use as manure or for production of complex fertilizers will attract a duty of 5 per cent.

Likewise, customs duty @ 5 per cent has been levied on imports of rock phosphate, crude/unrefined sulfur, phosphoric acid and naphtha for manufacture of fertilizers.

In addition, these will attract a surcharge of 10 per cent, thus, leading to an effective rate of 5.5 per cent.

In respect of ammonia used in the manufacture of fertilizers, even as in the relevant notification under the column pertaining to the duty, a dash sign has been put, from the relevant explanatory note (chapter 28, para 28.1 on page XXI of the budget bulletin 1999, customs), it would appear that ammonia imports will also attract a duty of 5 per cent.

Likewise, in regard to imports of urea for use in the manufacture of complex fertilizers which, in turn, is used as manure, the customs authorities, in some parts of the country, are taking a view that since such imported urea is allegedly not used as manure, they are insisting on charging duty at a much higher rate of 35 per cent.

On excise duty front, even as use of naphtha in manufacture of fertilizers (both feed and fuel) continues to be exempt, in respect of furnace oil, excise duty on its use for nonfeed purpose has been raised from existing 5 per cent to 8 per cent. Similar is the case in respect of LSHS on which duty has been increased from 5 per cent to 8 per cent on use as nonfeed.

Fertilizers being an essential input in agriculture and, in particular, production of foodgrains, the government controls their selling prices at low/affordable levels to farmers to induce increase in consumption. In a world of inflation, reasonable cost of production and distribution being higher, excess of this over selling price is reimbursed as subsidy. On imported urea also there is subsidy equal to C&F landed cost plus handling and distribution cost minus selling price.

In view of above, whereas all along imports of finished fertilizers as well as raw materials used in their manufacture such as rock phosphate, sulfur and ammonia were exempt from payment of customs duty, even on items wherein this was levied, i.e., fertilizer project imports and imports of phosphoric acid, based on recommendations of the JPC, these were abolished in August, 1992.

Against this backdrop, reintroduction of import duty on all these items will be retrograde step.

On the basis of calculations done by FAI, duty on imports of ammonia, phos acid, rock phosphate, sulfur, urea, DAP and MOP will lead to an additional expenditure of about Rs 450 crore per annum. In turn, this would lead to corresponding increase in subsidy outgo under RPS/ad hoc concession scheme.

Increase in excise duty on fuel oils/LSHS for nonfeed use in manufacture of fertilizers will also have the effect of increasing reasonable cost of production and, in turn, higher subsidy outgo under the RPS/ad hoc concession scheme.

The imposition of duty on fertilizer project imports and import of plant and machinery for revamp/modernization of existing units will lead to substantial increase in project cost and, in turn, higher cost of production by way of increase in capital related charges (CRC). Under RPS thus, new units will have to be given subsidy at a significantly higher rate.

The budget has also introduced a surcharge on corporate income @ 10 per cent. Consequent to this the effective rate of corporate tax will increase from the existing 35 per cent to 38.5 per cent. For urea manufacturing units this will lead to increase in pretax return on net worth from 18.46 per cent to 19.51 per cent and, in turn, subsidy under RPS.

In the railway budget for 1999-2000, freight rates have been increased across the board by 4 per cent without any exemptions. This would lead to a corresponding increase in cost of transporting all finished fertilizers as well as raw materials/intermediates including feedstock used in their manufacture.

The above together with cess of Rs 1 per liter on diesel, in turn leading to a significant increase in road transport charges on movement of both raw materials and finished products, will lead to significant increase in overall freight costs.

In turn this will increase subsidy under the RPS/ad hoc concession scheme.

Due to absence of domestic resources, the entire requirement of sulfur and MOP has to be imported. In the case of rock phosphate imports account for about 90 per cent of requirements.

About 80 per cent of phosphoric acid requirement has to be imported.

Likewise, the bulk of ammonia needed for production of DAP/complex fertilizers is imported. Urea imports – all on government account – are primarily for meeting the shortfall in domestic supply vis-a-vis demand.

In view of the above and the inevitability of imports, the argument of giving protection to the domestic industry by imposing import duty is not valid. Despite this, levy of customs duty on imports of fertilizers and raw materials/intermediates used in their manufacture will be counterproductive leading to higher subsidy outgo.

To prevent this the government should revoke these duties as well as duty on import of plant and machinery for new fertilizer units and revamp/modernization of existing units.