

No tinkering here

Fertiliser subsidy is too complex an issue to be tackled by one shot policy. It needs sustained efforts on various fronts, says Uttam Gupta

FERTILISER subsidy is rising to unsustainable levels. One policy option to deal with it is decontrol of urea. This means no control on the selling price and distribution, removal of the retention price scheme (RPS) and no subsidy.

To assess the likely impact, we need to consider two facts: (a) the current selling price of urea which is controlled, and (b) reasonable cost of production and distribution. The former is Rs 3,320 per tonne (excluding local taxes) and the latter is about Rs 6,000 per tonne, on weighted average, for the producing units (34 in all.) At the prevailing C&F landed cost of \$210 per tonne, the farmgate cost of imported urea is higher at about Rs 8,500 per tonne. The gap between (a) and (b) is plugged by subsidy.

Following decontrol — and therefore no subsidy — the selling price will inevitably rise. Considering that the domestic supplies of urea make up about 85-90 per cent, the market price will be determined by its average cost. The price to the farmer will thus rise to about Rs 6,000 per tonne or 80 per cent at one go. This will affect consumption.

Plants whose reasonable cost of production and distribution is above Rs 6,000 per tonne would become unviable. Fresh investment will not come in, because the reasonable cost for new projects would be at least Rs 9,500-11,500 per tonne, depending on the feedstock used. Old depreciated low cost plants will make fortuitous gains. However, they will not reinvest in capacity addition, which will be unviable. In short, we will have a sick and stagnant industry.

The government may introduce flat subsidy as it did for phosphatic and potassic fertilisers after their decontrol in August '92. Enabling a corresponding reduction in selling price may help check falling consumption. Still the supply constraints would remain. Because the total realisation (price paid by farmer plus flat subsidy) would still remain at Rs 6,000 per tonne, rendering higher-cost plants unviable.

Moreover, as the experience of P&K bears out, administration of such scheme is infested with problems like delay, unrealistic pricing at state levels and late payment to producers. Sops failed to arrest the fall in consumption during '92-96. Nor the consumption could be raised this year, despite the steep hike in concession in July '96.

Dual pricing is being talked of as a possible alternative. Under this, a certain target group, i.e. farmers having land up to 2 hectares (or the small and marginal farmers), is supplied fertilisers at the subsidised price i.e. Rs 3,320 per tonne. The rest have to pay a substantially higher price. Even if the government foots the subsidy bill, the price will be about Rs 6,000 per tonne.

To get an idea, let us consider total supply of urea from indigenous production — about 16 million tonnes (likely for '96-97.) For the industry to remain viable, the realisation from selling this quantity has to be Rs 96,000m (16x6000.) Sales to the small and marginal farmers being 4.8m tonnes (30

per cent as per an NCAER survey), at the subsidised price of Rs 3,320 per tonne, these would fetch Rs 15,936m (4.8x3320.) The shortfall in the expected revenue, Rs 80,064m (96,000 - 15,936) will thus have to be realised from selling the remaining quantities, that is 11.2m tonnes (16.0 - 4.8.) In other words, the free market sales have to be at a price of Rs 7,148 per tonne (80,064/11.2.)

Selling urea to the nontarget farmers at Rs 6,000 per tonne or Rs 7,148 per tonne is bound to invite resistance. They will not only buy less, but may try to corner the supplies meant for the small/marginal farmers. In a weak administrative setup like ours, diversions could defeat the objective of helping the target group.

In a limited way, dual pricing was tried during '91-92 by exempting the small and marginal farmers from the 30 per cent price hike effected from August 14, '91. The Centre allocated Rs 405 crore and disbursed the sum to the states in proportion to the likely consumption by the target group. The states were to formulate suitable schemes.

There is little information about how they did it. Conceptually, the manufacturers/distributors sell at the full price — Rs 3060 per tonne (after the hike) — to the farmer who, in turn, is expected to collect Rs 710 per tonne (corresponding to 30 per cent hike) from the government. The process involved making millions of such payments all over the country.

The scheme was a nonstarter and had to be abandoned from '92-93. Only 3.5 per cent of the target farmers benefitted from this scheme. In other developing countries

like Malaysia, Philippines and Sri Lanka, experiment with dual pricing had to be abandoned because of administrative hassles and leakages.

The other alternative is pricing on the basis of import parity (IMPP.) This involves linking the realisation of manufacturers to the C&F landed cost of imported urea plus handling and distribution cost. This does not help in reducing subsidy. On the contrary, the subsidy will increase sharply as at the prevailing C&F cost of \$210 per tonne, the IMPP will be about Rs 8,500 per tonne as against weighted average cost of domestic urea of about Rs 6,000 per tonne.

The production cost varies with unit due to factors of location, feedstock, vintage, financing pattern and the like. Since most plants were set up during the controlled regime, with government deciding the parameters, pricing was beyond managements' control. Against this backdrop, pricing on IMPP will lead to interunit distortions.

Again, the low cost depreciated plants would gain but new units would suffer a disadvantage, leading to stultified growth of the fertiliser industry.

The IMPP depends primarily on the international price of urea which, in turn, is decided by the global demand-supply balance and is therefore, highly volatile. Since '95-96, the prices are ruling high. However, the prices can also go down — as in mid-80s. In '86-87 the C&F landed cost declined to a low at about \$100 per tonne and more recently, during '93-94, the same was at about \$118 per tonne.

If the prices decline sharply, though the government may pay less subsidy on the



IMPP basis, it would entail a much higher cost considering that most plants would turn unviable. The loss of domestic production would inevitably lead to heavy imports leading to a sharp rise in the import price and the government may again land up incurring huge subsidy, and may even fail to ensure adequate and timely supply.

Fertilisers being an essential input whose consumption need to be raised to lift foodgrain production, its supplies have to be assured on a sustained basis. Linking the viability of domestic manufacturers to the IMPP will lead to frequent ups and downs and thus defeat the very objective.

Considering that sudden policy changes could be damaging, as was the case with P&K fertilisers, the right course may be to make a beginning by addressing the contributory causes of high subsidy. This would require a gradual increase in the selling price of urea and, at the same time, freezing the input prices at the existing level, besides scrapping various taxes and duties and reducing the interest rates.

This would help bridge the gap between the reasonable cost of production and distribution, and the selling price over a period of time. The savings in subsidy during this period will be a bonus. Increase in the urea price will also help reduce the distortion in its price vis a vis P&K fertilisers and achieve better balance in the NPK use ratio.

Once the gap between reasonable farmgate cost and the selling price is bridged, that may present an opportunity to test the efficacy of various alternatives. Even decontrol at this stage will not much upset the apple cart as then, the free market price will not be different from the controlled price which the farmers are used to paying.

For the manufacturers also, the reasonable cost of production and distribution will be fully taken care of, in a majority of cases. Only the new plants with much higher capital cost may be affected, for which the government may evolve suitable arrangements like one time capital subsidy to keep them viable.

To facilitate a smooth transition, there is a need to step up investment in irrigation, land development, farm implements and promotion of better farming practices, with focus on the small and marginal farmers. The saving in subsidy, from the selling price hike, may be used for this purpose. These measures will help improve yields and income levels and, in turn, in coping with eventual free market.

Fertiliser subsidy is much too complex an issue to be tackled by one shot policy prescription. It requires sustained efforts on various fronts, including the forward and backward linkages of the fertiliser industry with various sectors. It will require the burden of adjustment to be evenly spread/distributed over different sectors. It is, therefore, imperative to formulate a conducive, clear, consistent and coordinated fertiliser policy package to be implemented over a period for effective results.