

A case for urea decontrol

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ONLY a few months ago, the Committee of Secretaries was reported to have recommended indexing the controlled selling price of urea with increase in cost of production and distribution. This was a good idea particularly against the backdrop of almost no increase in the former for a decade i. e. July 1981 to July 24, 1991 and a reduction of 10 per cent in August 1992 which substantially nullified the increase of 30 per cent announced earlier through the reform-oriented Budget of 1991-92 with effect from August 14, 1991. Before June 10, 1994, the urea selling price at Rs. 2,760 per tonne was a meagre Rs. 410 per tonne, or about 17 per cent, higher than the Rs. 2,350 per tonne prevailing way back in July 1981.

The suggestion had merit because of two fundamental reasons. First, without stating in so many words, it indirectly recognised that a major reason for the phenomenal increase in fertiliser subsidy during 1980s (from Rs. 505 crores in 1980-81 to Rs. 4,800 crores in 1991-92) was the Government's decision to maintain the selling price of fertilisers at a more or less constant level despite manifold increase in the cost of production and distribution.

Needless to say, had the need for such an indexation between the cost on the one hand

even unearned due to their monopoly position). The farmers were happy because they were paying highly subsidised prices. Even the exchequer had no reason to be unhappy as much of the consequential increase in subsidy was anyway coming back to it as increased surpluses of the Government enterprises and departments. What came under flak was the Retention Price Scheme (and perhaps even its authors) as well as the fertiliser industry, merely because it was the conduit for administration of the subsidy.

Although, the suggestion of indexation may not help in undoing the damage done in the past, it would definitely help in setting things on the right trajectory. This is where the second important aspect of the suggestion comes in. It is known for certain that escalation in the input cost will continue unabated, that various items of fixed expenses will continue to increase and that fresh production capacity would be created at much higher capital cost. Consequently, if the selling price is maintained at present levels or increased at a snail's pace, history is going to repeat itself. In this context, the 20-per-cent increase in the selling price of urea announced with effect from June 10, 1994, though somewhat belated, was a step in the right direction.

But, the buoyancy generated by this initial positive reorientation in thinking and actions may not last long if one goes by a recent report

average cost for the industry may even rise to about Rs. 6000 per tonne. Because of the firming of the international prices, even the farm-gate cost of imported urea would not be less than this level.

In short, presently, with a selling price of Rs. 3,320 per tonne, the farmer is being subsidised to the extent of almost 100 per cent whether he sources the supply from domestic production or imports.

The difference of about Rs. 2,700 per tonne is nothing but the fertiliser subsidy having to come from the exchequer. On a total sale of about 17 million tonnes of urea (anticipated level for 1994-95), the burden on the exchequer would be about Rs. 4,600 crores. If this becomes unacceptable and the Government suddenly decides to decontrol urea and concomitantly abolish the RP and subsidy scheme, the consequences would be similar to what happened in the phosphatic sector wherein also when the latter was decontrolled overnight from August 25, 1992, the cost was almost double the controlled selling price and both the production and consumption suffered a serious set-back. In the case of urea, the repercussions could be far more dangerous as its use is twice as much that of phosphate and it is applied universally by all types of farmers and on all varieties of crops.

We should not dismiss this as a theoretical possibility merely because there is no longer any IMF pressure or the new GATT Agreement provides for a substantially higher level of subsidy on agriculture. If that were the sole criterion, then, why not bring back phosphate within the RP and subsidy scheme.

Let us not allow the build-up of a volcano which may erupt any time and devastate the fertiliser industry with serious adverse repercussions on foodgrains production and the country's food security.

To deal with it, as a first step, it is necessary to implement all pending recommendations of the JPC such as reduction in the price of natural gas, freezing the price of feedstock e. g. naphtha, fuel oil at their existing level (as in August 1992), elimination of excise duty on indigenous equipment supplies and lowering of the interest rates.

Second, beginning next year, i.e. April 1, 1995, the controlled selling price of urea should be raised by another 20-25 per cent. These two steps put together would help in substantially minimising the already existing wide gap between the cost of supplying urea and its selling price.

Third, from the overall macro-economic angle, there is no reason why the rupee should not be allowed to strengthen in relation to dollar (in line with the emerging demand-supply situation) to enable some reduction in the cost of imports.

Last, the concept of indexing the selling price with future increase in cost of production and distribution should be implemented in right earnest from, say, 1996-97 onwards. Only then would the producers and consumers of fertilisers, as also Indian agriculture, be adequately prepared to adjust themselves smoothly to the eventual decontrol of urea.

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and selling price on the other, been recognised and given shape, the fertiliser subsidy issue would not have assumed monumental proportions leading in turn to a host of destabilising policy orientations, particularly during the last three years. What was implemented by the Government was a system of fertiliser pool equalisation account, the idea being that whereas some units whose cost of production was lower than the controlled selling price would contribute the difference to this fund, others, whose cost was higher than the price would be paid the difference as subsidy. Consequently, there would be no net outgo from the exchequer.

This was not just theoretical, as units like GSFC in Baroda, IFFCO in Kalol and HFC in Namrup were in the former category, reimbursing the excess of their net rationalisation at the controlled selling price over their fair ex-factory (retention) price to the Government until early 1987.

The fact that this was intended to be a self-supporting mechanism (something like sugar, barring the present extraordinary situation when PDS sales are being subsidised) unfortunately got swept under the carpet even as the administered prices of inputs to the industry were raised with as much impunity as the decision of the Government not to touch the selling price all through the 1980s.

In the unfolding drama of events, the feedstock and input supplying organisations e. g. ONGC, IOC, OIL, Coal India Limited and the Railways were happy as they were showing fantastic increase in their profits (sometimes

in *The Economic Times* dated July 25, 1994. According to this, the contemplated package on the Retention Pricing Policy for the sixth pricing period i.e. April 1, 1991 to March 31, 1994 which is now proposed to be extended by another two years i.e. up to March 31, 1996, drops the indexation proposal. To bring out the implications, let us consider some numbers on both the selling price and the cost. Based on the latest notified retention prices (without the revision under sixth pricing which is yet to be announced) the reasonable cost of production and distribution (retention price plus freight plus distribution margin) on a weighted average basis for the industry would be in the range of Rs. 5,000 to Rs. 5,200 per tonne.

In sharp contrast, the present controlled selling price of urea is only Rs. 3,320 per tonne, almost Rs. 2,000 per tonne lower than the cost. If only the process that Dr. Manmohan Singh started in 1991 by increasing the price by 30 per cent had been continued with two more rounds of similar increases, there would currently have been no gap between the cost and the price. Besides, further hike in cost would have been taken care of by an indexation formula.

Unfortunately, because of the breaks in between and even reversals (10 per cent reduction from August 25, 1992 which was unwarranted), the hard facts are extremely worrisome. Once the revised retention prices for the sixth pricing are notified (these would be effective from April 1, 1991 - involving payment of huge arrears to manufacturers), the weighted