Editorial

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Decontrolled P and K

Depreciation, the bane

Apart from the high selling price, supply constraints caused by delays in price fixation, prices being set at unremunerative levels and delays in releasing payments have been responsible for the declining trend in the consumption of decontrolled P and K fertilisers. A three-pronged strategy, which includes making the rupee stable and stronger, will not only help reduce the cost of P and K fertilisers, but also yield rich dividends for the economy, says **Uttam Gupta.**

THE drop in the consumption of phosphorous (P) and potassium (K) fertilisers that started with their decontrol in August 1992, continues unabated. In 1995-96, the consumption of P at 2.8 million tonnes and K's at 1.16 million tonnes was substantially lower than 3.32 million tonnes and 1.36 million tonnes respectively in 1991-92 (before the decontrol).

In April-September 1996, the sale of DAP (diammonium phosphate) was 1.59 million tonnes against 1.79 million tonnes in the same period of 1995. The sale of MoP (muriate of potash) was 0.59 million tonnes and 0.71 million tonnes respectively. The emerging trends during the current Rabi season are not encouraging either. Thus, the consumption of DAP and MoP for the whole year is likely to be lower or at best equal to the already low levels of 3.3 million tonnes DAP and 1.35 million tonnes MoP of 1995-96.

Even as the consumption of urea continues to rise, the resultant heavy imbalance in the NPK use ratio has begun to show up by way of reduced crop yields. In 1995-96, this led to a substantial decline in the foodgrains production, by about 6 million tonnes. Before that — that is, in 1992-93 and 1994-95 — despite declining P and K use, production remained unaffected because their residual availability in the soil provided the much-needed cushion. However, in view of the rapidly depleting buffer, there can be no further complacency.

The major cause for the declining/stagnating trend in the consumption of decontrolled P and K fertilisers is the sustained and steep increase in their prices. For instance, the selling price of DAP has gone up from Rs. 4,680 a tonne before decontrol to about Rs. 9,000 now. Likewise, the price of MoP went up from Rs. 1,700 per tonne to Rs. 4,500 per tonne. The selling price depends on the reasonable cost of production and distribution. Of the former, the cost of raw materials/intermediates constitutes about 80-85 per cent. Considering that these have to be entirely imported, their cost depends primarily on their C&F landed cost in dollar terms and the prevailing exchange rate. Since decontrol, both these factors have turned adverse.

Immediately before decontrol, the C&F landed cost of phos acid was $ 375 per tonne. Then, its import attracted a Customs duty of 12 per cent on supplies from Morocco and Tunisia and 15 per cent from other sources. On a weighted average basis, this worked out to 13 per cent (taking 70 per cent of supplies from Morocco and Tunisia). Inclusive of the duty element thus, the C&F cost of phos acid was $ 423.75 per tonne. With this, and the prevailing C&F landed cost of ammonia at $ 118 per tonne, the cost of phos acid and ammonia in one tonne DAP worked out to about $ 229.36.

Under the then dual exchange regime, effective March 31, 1992, phos acid and ammonia (decanalised effective April 1, 1992) had to be imported at the higher market determined rate of exchange of one $ — Rs. 29. On this basis, the rupee cost of phos acid and ammonia in one tonne DAP worked out to Rs. 6,651 per tonne. Together with conversion cost, of about Rs. 2,000 per tonne (including capital related charges), freight of about Rs. 400 per tonne and a distribution margin of Rs. 200 per tonne, the reasonable farmgate cost was about Rs. 9,200 per tonne. The selling price being controlled at a low Rs. 4,680, the excess of the cost over this was subsidised under the retention pricing scheme (RPS).

Based on the JPC recommendation, effective August 27, 1992, the Customs duty on phos acid was removed. Then, in September 1992, import of raw materials and intermediates used in the manufacture of all phosphatic fertilisers (except single super phosphate) was allowed at the lower official rate of exchange, this being one $ — Rs. 25.89 then. There was some easing of the C&F landed cost of phos acid and ammonia to $ 340 per tonne and $ 112 per tonne respectively in respect of supplies during October-December 1992.

In view of the above, the cost of phos acid and ammonia in one tonne DAP dropped to $ 187.84 or Rs. 4,863 leading to reasonable farmgate cost of about Rs. 7,500 per tonne. With subsidy under the RPS being replaced by the *ad hoc* concession of Rs. 1,000 per tonne, the price to the farmer was thus Rs. 6,500 per tonne, still substantially higher than the pre-decontrol level of Rs. 4,680.

Unfortunately, the benefit of the various cost-reducing measures was available for a brief period only. As for the lower official exchange rate, even before the ink was dry, it was automatically withdrawn following introduction of full convertibility of the rupee on the current account and unification of the exchange rate, effective March 1, 1993. The benefit of removal of Customs duty on phos acid too was negated by the steep increases in the dollar prices of phos acid and ammonia, on the one hand, and the significant depreciation of the rupee on the other.

As of December 1996-January 1997, the C&F landed cost had reached $ 416.5 per tonne for phos acid and $ 250 per tonne for ammonia while the rupee depreciated to one $ — Rs. 35.8. At these rates, the cost of phos acid and ammonia in one tonne DAP works out to about $ 254.92 or Rs. 9,126 per tonne — a whopping Rs. 4,263 more than the cost in October-December 1992. Of this, while the increase in the dollar price accounts for Rs. 1,737, depreciation of the rupee for the balance Rs. 2,526 per tonne.

With the prevailing cost of intermediates alone at about Rs. 9,200 per tonne, and even assuming a conversion cost of Rs. 2,000 per tonne (same as four years ago), the reasonable farmgate cost works out to about Rs. 12,000 per tonne. Of this, Rs. 9,000 is paid by the former and balance Rs. 3,000 per tonne comes by way of concession support. Even as the conversion cost has increased substantially due to overall inflation, this has eroded the profit margins and pushed some of the manufacturers into loss-making situation.

Unable to sell the high-cost DAP, many manufacturers switched to the production of low analysis complex fertilisers to maintain their viability and give farmers a comparatively cost-effective option. This is reflected in substantial increase in the share of the latter in total P consumption from 21 per cent in 1991-92 to 28 per cent in 1995-96. Correspondingly, the share of DAP went down from 63 per cent to 55 per cent. From the viewpoint of maintaining soil fertility, this is not a healthy trend as, on a net basis, this results in overall reduction in the supply of P nutrient.

The consumption of P and K fertilisers can be revived only by maintaining their selling prices at reasonable levels. This would require a check on the cost-push factors; alternatively, the concession amount has to be raised suitably. Up to 1995-96, while there was substantial cost push, the concession amount remained unchanged at Rs. 1,000 per tonne.

As a result, the selling price increased from Rs. 6,500 per tonne in 1993-94 to Rs. 7,500-8,500 during 1994-95 and further to Rs. 9,500-10,000 in 1995-96. Effective July 6, 1996, the concession amount was raised to Rs. 3,000 per tonne, but this was inadequate to fully neutralise the cost-push effect. Consequently, the price, though somewhat lower than in the previous year, is still ruling at a high of Rs. 9,000 per tonne.

Apart from the high price, consumption has also been affected by the supply constraints caused by delays in price fixation, prices being set at unremunerative levels and delays in releasing payments due to involvement of the State governments. With an outstanding of over Rs. 1,000 crores, the payments position continues to be grim despite adequate Budget allocation and the Government's avowed commitment to speed up the process.

A three-pronged strategy is needed to reverse the current declining trend in P and K consumption. First, the rupee has to be made stable and, perhaps, even stronger. This being a macro-economic issue, coordinated efforts are needed to bring the balance of payments on to a healthy state. Plugging various loopholes in export-import transactions alone can help a lot in this.

According to a recent study by American economists, during 1994 and 1995, there was capital flight of $ 4.11 billions to the US due to under-invoicing of exports and over-invoicing of imports. An informal IMF estimate puts the total flight from India at about $ 100 billions. But for this, there would be a huge trade surplus, bulging foreign exchange reserves and, hence, much stronger value of the rupee.

The necessary efforts to prevent these leakages will not only help in reducing cost of P and K fertilisers, but also yield handsome dividends for the rest of the economy. Second, there is a need to bring down the dollar price of raw materials/intermediates.

This can be achieved by promoting joint ventures (JVs) in countries with abundant raw materials — Morocco, Jordan, Tunisia — with significant equity holding by Indian companies. When MNCs can successfully operate JVs with them, there is no reason why with the technological and managerial capabilities, they cannot do the same.

Third, the concession support would still be needed to maintain price to the farmers at reasonable levels. However, to eliminate various distortions in its implementation, the Government should fix indicative price in consultation with the industry before commencement of each season; ensure prompt payment of dues on receipt of monthly bills to the industry based on despatches as was the practice until August 1992 and continues even now in respect of urea, without involving State governments; and remove the uncertainty about continuation of the scheme on a year to year basis.

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