## Fertiliser reforms

# Two steps forward, one step back

*Having initiated long-needed action to remove controls on urea pricing and distribution in 2003, why is the government now going back on that decision? Distribution controls are relevant only in a situation of shortage, which is not the case with urea. So the rhetoric that decontrol is not in the country's interest hardly holds water, says* **Uttam Gupta**..

IN 2000, the Expenditure Reforms Commission (ERC) had recommended immediate removal of distribution control on urea from February 1, 2001. After a two-year wait, the Government lifted controls but only partially — 25 per cent during kharif 2003 and 50 per cent during rabi 2003-04. The relevant notification also mentioned that from April 1, 2004, controls would be completely withdrawn.

Now, the Union Minister for Chemicals and Fertilisers has ordered a review of the above decision. By doing so, he has given a clear indication of Government's intention to not merely refrain from bringing about total decontrol, but also to restore the dispensation as it existed before April 1, 2003 — that is, total control on the distribution of urea.

While distribution controls on phosphate and potash fertilisers were removed in 1992, the continued control on urea — both on price and distribution — with ever increasing subsidy support led to a worsening imbalance in fertiliser use and attendant adverse effect on soil health and crop yield.

Having taken more than a decade to recognise the need for rectifying this policy distortion, the Government initiated action only in 2003. Why does it now want to go back? Apart from the oft-repeated rhetoric that decontrol will not be in the interest of the country, it has not offered any valid explanation.

Distribution controls are relevant only in a situation of shortage, when domestic production is grossly inadequate to meet the demand and imports on the desired scale are not possible due to scarcity of foreign exchange. This indeed was the scenario in the early 1970s.

That was the result of a combination of factors — rapidly expanding demand (to meet the high nutrient requirements of high yielding variety seeds), low domestic production capacity, rising price of imported fertiliser (due to steep increase in price of crude oil) and an overall precarious BOP situation.

Since the mid-1970s, domestic production capability has been built up on a massive scale. At present, this is much in excess of the demand. Any surge in demand that may be triggered by favourable weather can be easily met by tapping unused capacity. Besides, we have the option of importing to meet the deficit, if any.

In the last five years or so, the Government has invariably allocated about Rs 500 crore for subsidy on imported urea (this can support about 2 million tonnes). But the allocated amounts remained unutilised year after year as the demand is fully covered by indigenous production, obviating the need for import. In view of above, there is not even the remotest possibility of urea shortage. Localised shortages are also ruled out as urea plants (33 in all) are well spread out across the country and can reach the product to farmers within economical distance.

Thus, following the discovery of gas in Bombay High and South Basin area in the early 1980s, a High Powered Committee (the Satish Chandran Committee) recommended that urea plants be set up near the major consuming centres in North and Central India, and the gas transported to these locations through pipeline.

Accordingly, the Government gave its nod to set up set up six strategically located plants (four in UP and one each in Rajasthan and MP). Concurrently, it also sanctioned setting up of a 1,700 km long gas pipeline (the H-B-J pipeline) from Hazira, in Gujarat, to Jagdishpur, in UP, to carry gas for these plants.

Clearly, the manufacturing facilities and the infrastructure for handling and distribution have been developed keeping in mind the need to effectively serve all parts of the country, particularly the potential deficit areas. There is absolutely no question of this getting dislocated by the mere act of removing distribution controls.

In phosphate fertilisers, ever since their decontrol in 1992, the country has not faced a shortage situation. This is when the majority of phosphate plants are located in coastal areas, far away from the prime consuming centres. In urea, where plants are spread all over, the situation is much more comfortable.

The remote and inaccessible areas — for instance, the North-East — could, however, face problems. But such situations can be addressed without having to control the entire distribution chain. The Government can always use its powers to direct any manufacturer to supply to these areas and give suitable incentives like transport subsidy. Under the new urea policy, the Government has mooted a fund of Rs 200 crore to subsidise the additional cost of transporting urea to the above difficult areas. With these arrangements already in place, it is most unlikely that a shortage situation would arise even in these areas.

While, retention/restoration of distribution controls has nothing positive to offer, this can only have negative consequences. At present, the freight cost is reimbursed to the manufacturers on a unit-specific basis. This practice is followed because the Government directs the producers where to sell and how much.

While, the unit-specific rate — say, 'X' — is applicable to the controlled portion (50 per cent of production), on the decontrolled portion (remaining 50 per cent), the Government allows a freight of 'X' minus Rs 100. By implication, therefore, the latter is also unit-specific. Therefore, reimbursement of freight on the entire production is unit-specific.

This system is bound to bring in a lot of subjectivity and lead to inefficiencies and cost padding. For instance, the authorities may build in a higher component of road transport (this is more expensive) in the rail-road mix for a particular unit or allow longer lead. This will benefit the concerned unit, but at the cost of the exchequer.

The Group Concession Scheme (GCS) for urea covers ex-factory production costs on a uniform basis within each group (there are six groups). When juxtaposed with the unit-specific dispensation for reimbursing freight cost, this can lead to serious inter-unit distortions. To get an idea, let us consider the following example.

Unit 'X' has ex-factory cost lower than group average (GA) but incurs higher freight in moving the product to the consumption point. Under GCS, it will get a higher GA as the concession but does not lose on freight, as the same is recognised on actual basis. Overall, it is a net gainer.

Another unit, 'Y', has ex-factory cost higher than GA but incurs lower freight in reaching the product to the farmer. Under GCS, it will get lower GA as concession, but gets no advantage for its lower freight cost as the same is recognised on actual basis. Overall, it is a net loser.

The concession payments are made to the urea manufacturers on despatch. The concession amount is a part of the realisation from sale, the other part being the farmer's price. While, the latter is realised only when the product is actually sold, the Government releases former the moment it leaves the factory. This defies logic.

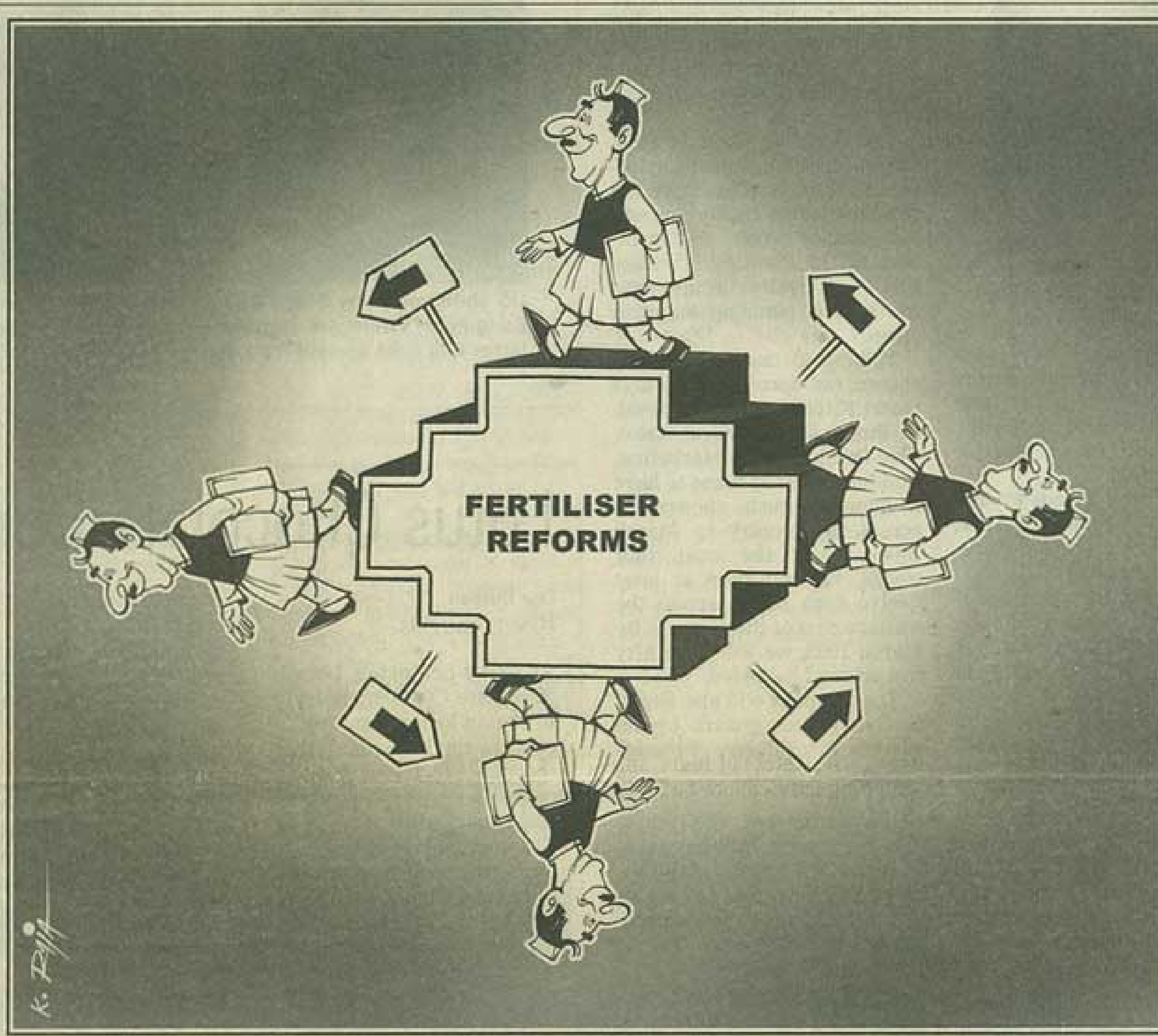
The ERC recognised this serious flaw and accordingly recommended payment of concession to the urea manufacturer on sale. Of course, this was predicated on its concurrent recommendation for complete decontrol of urea distribution. For phosphate fertilisers, the system of payment on sale has been in operation since 1992.

Since 50 per cent of the urea production is still under control, the Government somehow continues with payment on despatch (ironically, this facility is available even in respect of the balance 50 per cent free quantity). If, after the review, 100 per cent urea is brought under distribution control, this aberration may never get corrected!

Whichever way one looks at things — economic merit, the underlying demand-supply situation (after partial decontrol of urea since kharif 2003, there is no indication of any shortage anywhere) and the experience of P and K fertilisers — there is a strong case for completely dismantling distribution control on urea.

The Government must also consider removal of price controls and completely do away with subsidy payments. At a time when, it is talking of removing controls on foodgrains, there is no justification for retaining control on fertilisers, which is one of the inputs used in their production.

Simultaneously, it should allow free import of urea by anyone (at present, only designated state trading enterprises such as MMTC and STC can import). This will make available a vast pool of supply, inject competition and thus help keep the price to the farmer low.

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