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# Fertiliser reforms brook no delay

Uttam Gupta

The retention price scheme (RPS) for urea was introduced around 30 years ago, in 1977, with the two-fold objective of increasing its consumption and raising production.

Under the RPS, each producer was entitled to a given amount of ex-factory price realisation — known as the retention price — that would fully cover the production cost (raw materials/inputs and processing cost) plus 12 per cent post-tax return on net worth (shareholder funds).

As a result, there was a phenomenal increase in the installed capacity and utilisation during the 1980s and the 1990s. However, the system also led to the ballooning of the fertiliser subsidy besides raising widespread concerns over excessive payments made to manufacturers due its cost-plus nature.

In 2000, the Expenditure Reforms Commission (ERC-2000) recommended far-reaching reforms in the fertiliser sector leading to eventual decontrol of urea. The reform package sought to rationalise the price paid by farmers on the one hand and price received by producers on the other.

It recommended increasing the selling price by seven per cent per annum to reach the level of import parity price (IMPP) in five years; however, the ERC wanted small and marginal farmers to be exempt from the hikes by arranging for the differential to be given to them as fertiliser coupons.

### REPLACING UNIT-WISE RPS

As regards the producer price, in the first phase, the ERC recommended replacement of unit-wise RPS by a scheme of group concession under six groups — pre-1992 gas; post-1992 gas; pre-1992 naphtha; post-1992 naphtha; fuel oil and mixed-feed. It also proposed removal of distribution control.

For the second phase, it proposed revision in energy norms besides reduction in capital related charges (CRC), especially, for new plants. In the third, the ERC recommended that all naphtha- and fuel-oil-based plants switch to domestic gas or LNG (liquefied natural gas). In the fourth phase, the ERC wanted all producers be entitled only to IMPP plus a uniform amount to plants on LNG (to compensate for its much higher cost than domestic gas). With farmers also paying the IMPP, the Government would thus have virtually eliminated subsidy.

Pledging to implement the ERC package, the government of the day took some steps including replacement of the RPS by a New Pricing Scheme, or Group Concession Scheme in ERC parlance, from April 2003 (Phase I) and revision in energy norms and reduction in CRC from April 2004 (Phase II). It also partially removed distribution controls on urea — by allowing manufacturers to sell 50 per cent of their production outside ECA allocation — from April 2003 with the promise of complete removal of controls from the following year, that is, April 2004.

*Deregulation can open up the floodgates of foreign investment in the fertiliser sector. This can turn India from a deficit country to a hub for exporting fertilisers.*

### GAP IN PACE, CONTENT

However, there is a huge gap in both the pace and content. Against the February 2001 target set by the ERC, the government initiated the process in April 2003. On the farmers price front, there was no movement at all even as the price continued to fall short of IMPP by a huge margin.

The promise of completely removing distribution control from April 2004 has remained on paper even as the partial control dispensation continues till date. As per recent reports, the Government is even contemplating to bring urea "fully" under distribution control.

The government does not appear keen to implement the ERC recommendation for extending direct support to resource-poor farmers. The Department of Fertilisers has rejected the idea of implementing this even on an experimental basis in selected districts.

Asregards producer price, the reforms have failed to move beyond the second phase. Even the changes made during the first and the second phases do not conform to those contemplated by the ERC. For instance, against a "uniform" concession for all plants within each group envisaged by it, under the NPS the concession varies from plant to plant.

### 'PIECE-MEAL' CHANGES

The Government continues to attempt "piece-meal" changes under the NPS. For instance, for quantities in excess of 100 per cent capacity utilisation level, the NPS had a provision to allow producers to retain 35 per cent of the difference between the IMPP and the variable cost. The logic put out was that for production above 100 per cent level, realisation from sale in excess of the variable cost would be a surplus accruing to the producer and therefore needs to be shared with the government. The premise is flawed.

This is because due to shortage of gas, incremental production has to come entirely from use of expensive naphtha. As a result, just the variable cost exceeds the IMPP; hence, there is no surplus. In this backdrop, a recent move to allow manufacturers to retain the "entire" surplus makes no sense.

While, mooting the idea, reportedly, the Government has argued that its intention is to provide incentive to low cost units. The intended reward – as clarified above – is theoretical. Such units will benefit only if, concession on their "entire" production is linked to IMPP.

### LOW COST UREA

The gas-based units produce urea at low cost because of significantly lower cost of gas than naphtha and fuel oil. Besides, the former operate at higher efficiency levels. And yet, the NPS denies them this advantage by paying them on their actual cost under separate group, that is, pre-1992 gas and post-1992 gas.

On the other hand, the substantially higher production cost of naphtha and fuel oil based plants is protected by recognising their actual under pre-1992 naphtha and post-1992 naphtha and fuel oil group. The NPS is nothing but unit-wise RPS in a new incarnation.

When the rest of the economy is witnessing sweeping reforms, there is no reason why the Government should keep the fertiliser sector insulated. It must reform at "One Go" by completely liberating urea from pricing and distribution control. The NPS must be scrapped and all urea producers should be paid the IMPP.

### UNLEASHING NECESSARY FORCES

This would automatically unleash all necessary forces (high-cost units will either down shutters or take swift action to become competitive, while low-cost units will further consolidate) that are needed to turn the fertiliser industry in India into a vibrant and competitive industry.

During the last three decades or so, not a single foreign corporation has shown interest in the Indian fertiliser industry (those that came in before the RPS introduction in 1977 have either already exited or are planning to do so), while FDI has flowed in torrents to other sectors.

De-regulation can open up the floodgates of foreign investment in this vital sector as well. This can turn the Indian fertiliser scene from one of perennial deficit (all along, India has been a net importer) to even making India a hub for exporting fertilisers.

In recent years, several Indian companies have been looking for joint ventures in countries well endowed with gas. There is need to encourage setting up of joint ventures in India, which will be cost-effective and contribute to industrial growth. Fertiliser reforms will help this process.

A competitive and low-cost fertiliser industry will be able to supply fertilisers to Indian farmers at an "affordable" price without the Government having to foot every year a subsidy bill that runs into thousands of crores of rupees.

*(The author is Resident Director, CropLife India, New Delhi. The views are personal.)*