

Fertiliser sector awaits reform

► *The existing fertiliser pricing system is a fiscal burden on the government, apart from not benefiting the producers. Decontrol would encourage production and balanced nutrient use.*

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In its meeting held on February 18, 2010, the Union Cabinet took following three important decisions: To increase the maximum retail price (MRP) of urea by 10 per cent; decontrol prices of all other fertilisers; and move to a nutrient-based subsidy (NBS) regime.

The above policy decisions are being interpreted as an indication of the government's intention to liberalise the fertiliser sector, granting freedom to the manufacturers in pricing and making available to farmers a diverse basket of products to suit their soil and crop needs. How far is this true?

UREA PRICE INCREASE

The increase in MRP of urea from Rs 4,830 per tonne to Rs 5,310 per tonne, a meagre Rs 480 per tonne or Rs 24 per bag (one bag contains 50 kg), has come after a long gap of eight years (the price was last revised in 2002).

The Expenditure Reforms Commission (ERC), which laid down the blueprint for reforms in the fertiliser sector in 2000 (the government had then decided to implement its recommendations in toto), wanted urea price to be totally decontrolled by 2005-06. Five years later, we are nowhere near achieving this objective.

The government is yet to divulge its mind on what it proposes to do to with the convoluted New Pricing Scheme (NPS) — a new incarnation of the quarter-century-old retention price scheme (RPS) — that was launched in 2003 for making subsidy payments to urea manufacturers.

The NPS places manufacturing units into six categories,

namely, pre-1992 gas; post-1992 gas; pre-1992 naphtha; post-1992 naphtha; fuel oil/LSHS based and plants based on mixed fuel. Though the scheme intends one retention price for each category, in reality, unit-specific prices are offered.

Had the government followed the ERC road-map, these categories would have disappeared way back in 2005-06. All producers would have in fact, been attuned to market-based prices.

MYTH OF DECONTROL

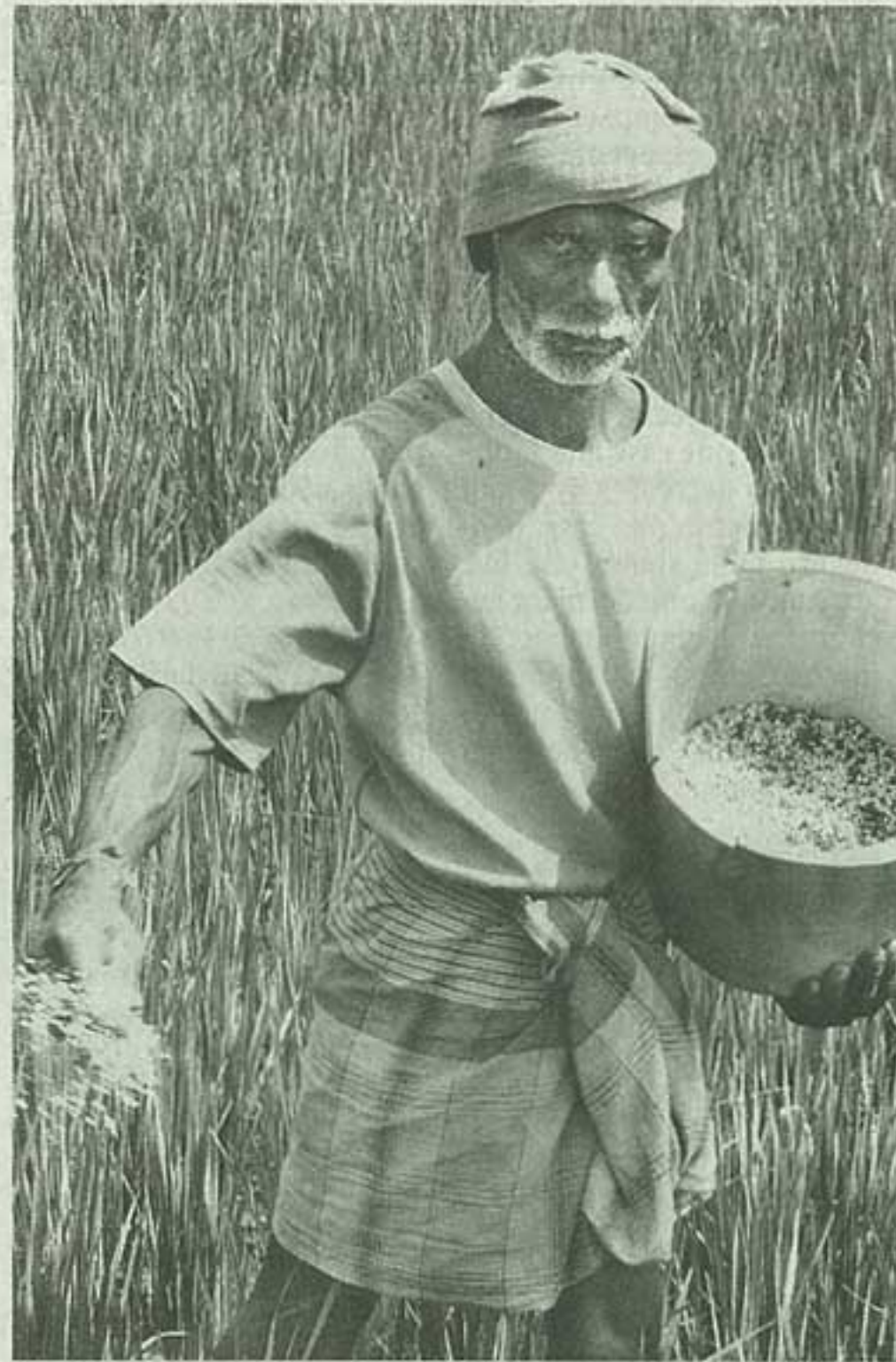
It is claimed that the producers of all fertilisers other than urea (there are 18 in all, mostly complex fertilisers containing N, P & K nutrients in varying proportions) will have the flexibility to fix their respective MRPs. This is a myth.

Till now, as in the case of urea, the MRPs of all these fertilisers are fixed by the government. For complex fertilisers, since last year, these are determined on the basis of the per unit nutrient price of N, P & K derived from MRP of urea, DAP & MOP, respectively.

Since these MRPs are way below reasonable cost of supply, the difference is reimbursed as subsidy to the producers. For DAP and MOP, the subsidy is calculated with reference to their respective import parity price (IPP).

Now, when the government says that manufacturers will have the freedom to fix MRP, it must be understood that it is not dispensing with subsidy. The latter will continue to receive subsidy; only the manner of determination will change under the proposed NBS.

How can the government grant subsidy (accounting for



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50 per cent or even more of the producer's realisation) and yet not have a say in the MRP? The fact of the matter is that it will continue to control MRP as well.

In August 1992, based on the JPC (Joint Parliamentary Committee) recommendation, the government had decontrolled all 'P' & 'K' fertilisers. Producers were free to fix MRPs, but they were not to get subsidy.

Since cost of supply was substantially higher than what the farmers were paying before decontrol, in the absence of subsidy, producers had no option but to raise MRP. That led to a huge backlash, and in less than a month the government resurrected subsidy as an "ad-hoc concession". It reintroduced control on MRP as well.

There is no reason to be-

lieve that circumstances have changed. The government has sought an assurance from the manufacturers that during kharif 2010, they would not increase MRP of the so called de-controlled fertilisers or keep the increase, if any, to the bare minimum — and the latter have no option but to follow the diktat.

Under NBS, the government is likely to determine subsidy on per tonne basis only on the 'N', 'P' and 'K' content of any fertiliser. These would be benchmarked to the IPP of urea, DAP, MoP. NBS avoids detailed costing thus making system simpler and more transparent.

NUTRIENT-BASED SUBSIDY

NBS expected to come in force from April 1, 2010 (provided the inter-ministerial group is ready with the de-

tails by then). But it is unlikely to unleash the energies of manufacturers.

This is because the government has done little to address the basics. The biggest stumbling block under existing dispensation (for all fertilisers) is the inability — of even the best among all producers — to fully cover the reasonable cost of supplying fertilisers to the farmers.

When there is an increase in production cost (due to a steep increase in the cost of raw materials), the government does not permit the required adjustment in subsidy, due to fear of increase in fiscal deficit, and in MRP, due to fear of political backlash.

These imponderables will dominate during 2010-11 as well. The government is determined to lower fiscal deficit to 5.5 per cent and proposes to have a tight leash on fertiliser subsidy. Faced with opposition even from within UPA, it may not even permit increase in MRP.

WAY FORWARD

Direct payment of subsidy to farmers is not on the government's radar. This most crucial reform of the fertiliser sector is pending for close to a decade; it brooks no further delay.

The government should also remove pricing and distribution controls on all fertilisers including urea. This will attract investment in production capacity.

Continued imbalance in the NPK ratio is the outcome of excessive use of urea as a result of its low MRP vis-à-vis MRP of P & K fertilisers, all of which are controlled by the government. This can be corrected only in a market-based regime for retail prices.

The decontrolled regime will make a big dent on the ballooning subsidy bill. Besides, direct payment of subsidy to the farmer will encourage judicious use of fertilisers.

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