

Fertiliser subsidies

Gearing for WTO-compatible regime

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EVEN AS the D-day for the removal of quantitative restrictions (QR) on imported urea in (April 2001) draws near, it is time to make a critical assessment of whether or not the existing policy dispensation for fertilisers is compatible with our obligations under the World Trade Organisation (WTO). And if not, what needs to be done to make it compatible?

Under the Agreement on Agriculture (AOA), if, for any developing country, the aggregate measure support (AMS) expressed as a percentage of the value of agricultural production is less than 10 per cent, it is not required to undertake any reduction. Fertilisers being an essential input in agriculture, the subsidy on it forms a part of non-product-specific subsidies, which together with the product-specific subsidies gives the AMS.

The current AMS level being substantially negative at 31 per cent, India is free from undertaking any reduction. However, this should not make us complacent. The overall negative AMS subsumes substantially negative product-specific subsidy of 38 per cent and non-product-specific subsidy of 7 per cent. Some developed countries, particularly the CAIRNS group, feel that for the purpose of assessing conformity to obligations under the WTO, the two types of subsidy cannot be clubbed. If this is accepted, then no set off would be available against product-specific subsidies. Even though the non-product-specific subsidy at 7 per cent would be lower than *de minimis* level of 10 per cent, the cushion available would be thin.

This year, the prices of liquid hydrocarbons — naphtha, fuel oil and LSHS — increased sharply. In the case of gas, consequent to a slew of decisions — the removal of the cap on its basic price, and increased linkage to the import parity price of internationally traded fuels from the existing 75 per cent to 100 per cent — the price is slated to double. Considering this and the lack of a political consensus on the increase in urea's selling price, even in small doses (notwithstanding the recommendation to this effect in the *Background Paper on Long Term Fertiliser Policy*), the fertiliser subsidy bill is expected to increase phenomenally.

This, together with the increasing subsidy on other agricultural inputs such as irrigation, power and seeds, could lead to the disappearance of the available mar-

gin. The possibility of non-product-specific subsidy exceeding the *de minimis* level of 10 per cent has not been ruled out. Consequently, reduction may be required over a stipulated time frame. Thus, the pressure of reduction will be felt in all areas, including fertilisers.

The issue of whether or not the product-specific subsidies will continue to remain in the negative zone must also be examined. While the international prices of agricultural commodities have declined sharply in recent years, the procurement prices of various food crops have increased. Against this backdrop, re-computing the AMS with the latest data could change our status from the negative to marginally negative, or perhaps even positive. In that situation, even if the set off continues, it may not be of much help.

A close scrutiny reveals that low international prices of agricultural commodities in recent years is largely the result of unprecedented increases in subsidies in developed countries. Thus, for the OECD group, AMS (includes support to producers and general services) had declined from 52 per cent in 1986 to 42 per cent in 1997, zoomed to 55 per cent in 1999. In absolute terms, the total hand-outs in 1999 amounted to \$300 billion up from \$258 billion in 1986. Clearly, far from honouring reduction commitments under the AOA, developed countries violated these with impunity.

This fact that the prevailing international prices of agricultural commodities are highly distorted and, therefore, cannot be a valid basis for calculating the AMS should be driven home forcefully. At the same time, strong efforts must be made to reduce cost, especially of the feedstock, to rein in subsidies, which would also help in fiscal consolidation.

Currently, the subsidy on fertilisers is routed through producers by way of compensating them for excess of reasonable cost of production and over the selling price which is kept at a low and uniform level (this mode is adopted for administration ease, cost-effectiveness and is least prone to misuse). Further, due to wide variations in the production cost caused by unavoidable differences in feedstock, location, technology and vintage, under the urea retention price scheme (RPS), each unit is entitled to specific subsidy. With respect to imports, which are now canalised, subsidy is equal



to the excess of C&F landed cost plus handling and distribution cost over selling price.

Phosphatic fertilisers were decontrolled in August 1992 and the RPS covering these was withdrawn. Concurrently, these were decanalised and imports allowed. Since October 1, 1992, however, these were covered by differential concession support under which domestic DAP is entitled to higher concession than on imported DAP. In the past, differentials were about Rs 1,000 and Rs 1,500 a tonne. In the first two quarters this year, they were Rs 3,400 a tonne and Rs 2,350 a tonne respectively.

In terms of AOA's Article III, dealing with National Treatment, any charges, taxes, laws, regulations and requirements introduced by the government should ensure that these extend similar treatment to the products originating from all our trading partners (called the most-favoured-nations, in WTO parlance) and that these do not result in discrimination against imports when seen in relation to domestic production. With regard to the MFN status, there is already uniformity of approach in dealing with fertilisers (including the raw materials used in their production) sourced from various countries. However, on the important question of domestic production versus imports, close examination is needed.

In this context, it may be noted that the selling price of urea is uniform, irrespective of the material being sourced from

domestic production or imports. Both the Background Paper and the Expenditure Reforms Commission (ERC) have recommended the continuation of this dispensation (even as both have recommended periodic increases in selling price over 5-6 years, this does not lead to any fundamental change as the price will remain uniform all through). Under the concession scheme, the selling price of phosphatic fertilisers is also uniform. The arrangement is fully compatible with our obligations under Article III.

With regard to subsidy/concession support, considering that the cost of feedstock in India is substantially higher than in exporting countries (\$2.5 per million btu for gas-based plants along HBJ, about \$6 per million btu for fuel oil-based plants and about \$7.5 per million btu for naphtha-based plants against less than \$1 per million btu in West Asia), in turn leading to high production cost, the required support to the domestic industry will have to be higher than on imported urea. Whether this could be perceived as unfair and discriminatory needs to be examined.

Even as there is much media hype over the continuation of the RPS being incompatible with the WTO obligation, the real issue here is not the form of the administered price regime (APR) under which subsidy is given, but giving the subsidy to domestic units at a rate higher than on imported urea. Even under the group-wise urea concession scheme recommended by the ERC, concession support

to domestic units would be Rs 8,400 a tonne for naphtha-based plants without adjustment for IMPP (Rs 6,500 a tonne with adjustment) which is significantly higher than the required support of about Rs 2,000 a tonne on imported urea (based on the prevailing C&F cost of \$110 a tonne). If higher concession support to domestic producers is held inconsistent with the WTO, it should still be possible to afford protection to domestic industry by levying duty on imported urea at an appropriate level. Though the bound rate for urea has not been declared, there should be no problem choosing the right level. It is hoped that the WTO Task Force on Fertilisers will come out with suitable recommendations in this regard. However, this would still not take care of the high-cost plants, especially those based on naphtha and fuel oil.

These could be protected by substantially reducing the cost of feedstock to them from the high level now. Both the Background Paper and the ERC have recommended the switch-over of all naphtha and fuel-oil-based plants to LNG. However, that is a long way to go. Apart from the uncertainties over its availability, there are the problems of inadequate internal generation under the RPS and alternative packages mooted by the HPC (1998) and the ERC (2000). If they have to survive the onslaught of a WTO-compatible regime, there has to be an immediate reduction in the price of feedstock.

In the case of DAP, the domestic industry is at a disadvantage due to the prices of imported phos acid and ammonia in one of tonne DAP being either more, or at best equal, to the C&F cost of the imported DAP. Further, the processing cost, including capital-related charges (CRC) and other fixed costs, compound the handicap. The higher concession support to domestic units is intended to overcome this. It is an attempt to offset the discrimination that already exists due to the peculiar pricing of raw materials/intermediates *vis-a-vis* finished products by global suppliers.

Considering the above, we need to continue the differential concession scheme. Concurrently, the option of levying import duty at an appropriate level should be vigorously pursued. This would require raising the bound rate on imported DAP from the existing low of 5 per cent as per procedure laid down under the AOA. While this may take some time, in the interregnum, the Government could levy a safeguard duty under Article XIX to prevent any threat of a sudden surge in imports.

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