

## Fertiliser subsidy conundrum

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**I**N THE background paper on the Long-Term Fertiliser Policy, the Government noted that farm subsidies in India are much less than those in some of the developed countries. At the same time, it has strongly recommended the need for a ceiling on subsidy to keep the overall fiscal deficit within manageable limits.

As far back as 1991, the government of the day had made a commitment to the IMF that the fertiliser subsidy would be eliminated in three years. Thereafter, even as the IMF pressure eased, it continued to emphasise the need for pruning subsidy. Yet, subsidy payments on fertilisers zoomed from Rs. 4,400 crores in 1990-91 to Rs. 13,250 crores in 1999-2000.

The subsidy is paid to cover the excess reasonable cost of production and distribution over the selling price, which is controlled by the government. The former is also controlled, but indirectly, through control on feedstock prices (until April 1998, prices of naphtha, fuel oil/LSHS were controlled; even thereafter, oil companies have been fixing prices based on Petroleum Ministry guidelines. Gas prices have been under control all through), cost of power, rail freight besides taxes and duties.

Since 1980, the cost of feedstock has zoomed — of naphtha 22 times, fuel oil 12 times, offshore gas at landfall point/onshore gas nine times and gas along HBJ 12 times. During this period, railway freight went up 5-6 times. In sharp contrast, the selling price of urea increased only three times. The increase in the cost of production and distribution being much higher than that in selling price, the jump in subsidy was inevitable.

Between 1990 and 1999, the cost push because of the increase in naphtha, fuel oil/LSHS and gas prices (ex-refinery/basic price is considered for computations) alone was about Rs. 8,000 crores. During this period, the extra realisation from increase in the selling price of urea was about Rs. 3,500 crores. Consequently, the uncovered gap of about Rs. 4,500 crores was reflected in correspondingly higher subsidy payments.

The JPC (1992) had recommended a reduction in the basic price of gas by 35 per cent; freezing prices of other feedstock; a reduction in charges for moving gas along HBJ; and removal of royalty on gas (por-

tion accruing to the Centre). In regard to the selling price, the Ninth Plan Working Group had recommended a phased increase — that is, 30 per cent in 1996-97 and 10 per cent per annum beginning 1998-99 for four years until 2001-02.

Even as the above recommendations were not implemented, attempts have been made to camouflage the real issues. While at one level, the Government resorted to 'pin-pricks' under the Retention Price Scheme — such as tightening of pricing norms, delays in revision of retention price and release of payment, and disallowance/inadequate reimbursement of reasonable cost under various heads — at another, a host of accusations has been levelled primarily to malign the industry.

Some critics say that the subsidy is paid for the alleged inefficiency of fertiliser plants. The reality is that the efficiency of the fertiliser industry is comparable to the best in the world. According to the National Productivity Council (NPC), the average energy consumption expressed as million Kcal per tonne ammonia is 11.25 in India against 12.23 in the UK, 11.32 in the US and 9.92 in Italy. For gas-based plants alone, the average in India is 9.18. However, this fails to impress the critics. Their opinion is that since subsidy is paid, the plants must be inefficient!

Without subsidy, the selling price will be market-based and, therefore, higher than the present controlled level. Subsidy, thus, helps in keeping prices low which, in turn, enables production of foodgrains and other crops at low cost. Therefore, its benefit accrues to consumers of foodgrains/other crops. And, yet, because subsidy is routed through industry (this is primarily for administrative ease and cost effectiveness), critiques insist they are the beneficiary!

Citing import parity concept, some experts have argued that to the extent, the cost of domestic supply is higher than that of import, the industry is subsidised. What happens when the former is lower than the latter (as was the situation for much of the 1990s and in the 1970s)? Logically, on this benchmark, the industry is taxed.

It is also argued that the "gold-plated" plants — a euphemism for actual capacity being higher than declared — get away with higher retention prices thereby leading to what some economists describe as 'fantastic profits'. But where are these?

Despite high capacity utilisation, units are not able to reach even the assured return of 12 per cent, post-tax. If they were to operate at normative level, the returns would be much lower or even losses in some cases!

From April 1, 2000, the capacity of plants reporting high utilisation has been re-assessed — purportedly to mop up hidden benefit — resulting in significant lowering of retention price. This will have a serious debilitating effect on the bottom-lines of companies concerned.

Another talking point is that under the RPS, new plants are cross-subsidised by older plants. This is far from the truth. As the retention price of almost every plant is higher than the realisation from sales at controlled price, the subsidy is received by all. In fact, the subsidy to majority of old vintage plants (these are based on naphtha and fuel oil) is significantly higher than that of new plants (majority of these are based on gas).

Such misconceptions have led to adverse policy re-orientation and an overall uncertain policy environment (the inordinate delay in the formulation of a long-term policy can be largely attributed to this). And, yet, the subsidy continues to grow unabated, because the fundamental factors have not been addressed. Will the fertiliser Policy's Background Paper help bring the real issues to the centre stage?

Even as the paper proposes periodic increase in selling price, experience does not instill much confidence. From July 25, 1991, the price was raised by 40 per cent; however, from August 14 1991, the hike was reduced to 30 per cent even as small and marginal farmers were exempt. With effect from June 1, 1998, an increase of Rs. 1,000 per tonne or about 27 per cent was proposed; however, in less than two weeks, this was fully rolled back. In January 1999, the Government barely scraped through a modest hike of 9.6 per cent.

In view of the above as also the reported statement of the Chairman of the Standing Committee of Parliament on Chemicals and Fertilisers, Mr. Mulayam Singh Yadav, that the Committee is opposed to any increase in the selling price of fertilisers, it is anybody's guess if the Government would be able to carry out the intent expressed in the Background Paper.

The Background Paper talks of formulating a feedstock policy. When the feed-

stock were under the administered price regime (APR), the Government resorted to steep increases in prices. Now, with the already dismantled APR and the impending decontrol of gas price next year, it seems unlikely that prices would move south. The spurt in crude price to which feedstock prices are ultimately linked, further adds to the concern.

The country's macro managers are insensitive to sectoral concerns. When dollar price of imported crude/petroleum products zooms and rupee depreciates, it is bonanza for the exchequer by way of higher Custom revenues. Despite this, the Finance Ministry is not inclined to conceding the demand for lowering the import duty. It makes little sense to collect more revenue which is spent as higher subsidy!

The Background Paper has recommended that all existing naphtha and fuel oil-based plants switch to LNG in five years. Even existing gas-based plants will have to tie up with LNG (a number of them have already signed MoUs with potential suppliers) as domestic gas supplies are not adequate and future prospects are grim. However, from the subsidy angle, the real issue is the LNG price.

In this context, Petronet LNG — a consortium of PSUs in oil and gas sector and a front runner in setting up LNG projects — has reportedly indicated that LNG would be priced at 85 per cent of the prevailing price of naphtha, which is about \$7-8 per million BTU. If these levels continue to prevail, the LNG price will be as high as \$6.0-7.0 per million BTU.

In this context, there does not seem to be much hope for tackling feedstock or selling prices. In other areas such as power, railway freight, road transport, taxes and duties — both at the Central and state level — the rates/charges are on the rise. This despite the loud talk of reforms in the sectors concerned.

Rising fertiliser subsidy has so far defied solution. This is because it has been treated as an issue pertaining only to the fertiliser industry. The reality, on the other hand, is that developments in other sectors have a profound impact on subsidy. The need of the hour is to formulate a coordinated and integrated approach.

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