THE HINDU **BUSINESS LINE**

Opinion

Monday, July 3, 2000

Fertilisers: Meeting WTO commitments

Uttam Gupta

WHILE debating the fulfillment of India's obligations under the World Trade Organisation (WTO), several measures have been suggested. The fertiliser subsidy will have to be drastically reduced; controls on pricing and distribution of urea will have to go; the RPS will have to be abolished; and higher concession support to domestic DAP will have to give way to uniform concession on both domestic and imported material. The transition needs to be carefully handled to prevent serious effects.

On agricultural subsidies, the Articles of Association (AOA) require that a developing country need not undertake any reduction commitments if, aggregate measurement support (AMS) as a percentage of production value is less than 10. The current AMS level in India is far below 10 per cent.

According to an estimate, where the product-specific subsidy is about minus 38 per cent, on agricultural inputs (including fertilisers), it is 7 per cent, resulting in an overall AMS of minus 31 per cent.

The developed nations, particularly those belonging to the CAIRNS group, namely, US, Australia and New Zealand, feel subsidies on agricultural inputs should be de-linked from the product-specific subsidy. This would mean that even if the latter is negative (in India's case, it is substantially negative), this would be treated as zero and no set-off would be available against the former. In other words, the subsidy on inputs would have to be assessed on its own.

Though the subsidy on inputs, at 7 per cent, is still lower than 10 per cent, the margin is very low. The possibility of increase is not ruled out, particularly in view of the steep increase in cost of inputs, including feedstock, and the resistance to even a small hike in the fertilisers' selling price. And, as and when, it crosses the 10 per cent mark, we could undertake reduction.

Even before the WTO commitments attracted attention, the campaign to slash subsidies was on, with the aim of reducing the overall fiscal deficit. However, the subsidy bill kept rising primarily because the fundamental causes were never addressed. Now, in some quarters, the WTO conditions are being used to buttress the case for subsidy reduction!

This seems to be a case of confusion of issues. As far as the WTO is concerned, there is no compulsion for a drastic curtailment in subsidy. The stress should, however, be on proper subsidy management. This would require a reduction in prices of inputs, particularly feedstock, utilities such as power and water, and services such as railway freight, on the one hand, and a gradual increase in the selling price of fertilisers, on the other.

It should also be recognised that the bulk of the fertiliser subsidy is intra-economy transfer, that is, money going from the Budget head to the surplus of Government undertakings — particularly in the petroleum and gas sector — supplying inputs to the fertiliser industry. If only the feedstock cost is reduced, though it would result in lower surpluses for these undertakings, the savings in subsidy payments to fertiliser units would be greater (to the extent of local taxes that are levied on an *ad valorem* basis and reduction in working capital). In the net, therefore, the exchequer would gain.

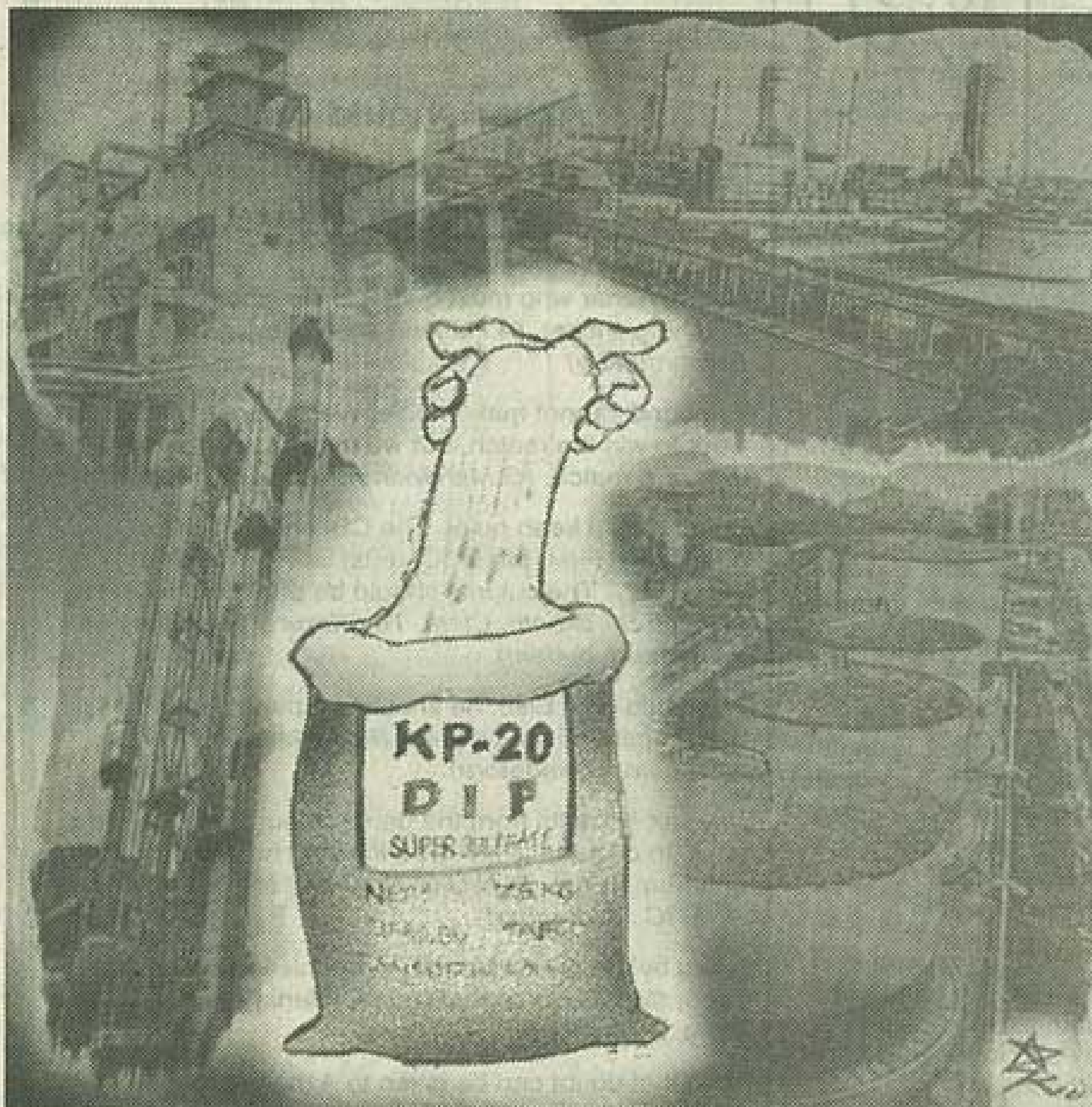
The Government may introduce a scheme to compensate its undertakings directly for the reduced realisation arising from lower input prices (the current pricing structure for feedstock/fuel is seriously flawed; prices are, in fact, fixed at levels that suit oil/gas companies, violating all other norms). A lot of effort has to go into what constitutes reasonable price, and payments should be made on that basis only). Thus, even as these undertakings are fully protected, expenditure under the fertiliser subsidy head in the Budget will fall drastically, providing greater flexibility *vis-a-vis* the WTO commitments.

The question of lifting urea pricing and distribution controls is linked with the removal of quantitative restrictions on its imports. With respect to the latter, the Centre has committed itself to dismantling the QR regime by April 2001. In view of this, and when free imports are permitted, it would be illogical to continue internal controls.

What happens to the RPS? The rationale for its introduction was two-fold. First, as the controlled selling price is unrelated to reasonable cost of production and distribution, which is higher (due to inflation and the high feedstock cost), producing units had to be compensated for the difference to prevent unwarranted loss and ensure a reasonable return on investment.

Second, due to wide variations in the reasonable cost of production, the system is unit-specific. So, even as the Government fixes norms for capacity utilisation and consumption of inputs, including feedstock, costs beyond unit-specific control, namely, delivered cost of feedstock, capital cost and other fixed costs, are allowed on reasonable actuals.

In a no-control situation, the selling price is market-driven. Producers could, then, hope to cover their reasonable cost entirely from sales realisation. The need for any compensation would, therefore, not arise. The *raison d'etre* for continuing with the RPS would, then, have to go. However, the Government will have to take steps, such as increasing the procurement price of farm output and providing direct income support to poor farmers to mitigate the adverse effects of the resultant steep increase in price to farmers.



The impact on industry also needs to be carefully assessed. The broadly uniform price realisation in a market- driven framework will price out high-cost units despite their being efficient. This is primarily because feedstock cost to them is substantially higher, about $7 per million Btu to naphtha- based plants, as against about $3 per million Btu to gas-based units. Within each feedstock group also, some plants pay higher than others (the difference could be as high as a dollar per million Btu in some cases) primarily due to the differential effects of transport cost and local taxes (for instance, a unit located in Gujarat has to pay sales tax on naphtha at 20 per cent as against 5 per cent in Uttar Pradesh or Rajasthan).

The Government should take steps to reduce the basic price of feedstock, particularly naphtha and fuel oil, and aim at a uniform price in energy terms.

It should also reduce the cost of transporting gas (see JPC recommendations) and recover this uniformly from all units, irrespective of location. It should also bring about uniformity in local tax regimes (this would require doing away with a host of taxes other than sales tax and maintaining the latter at a bare minimum, say, no more than 4 per cent). The majority of high-cost naphtha- and fuel oil-based plants are of old vintage and need to be modernised to maintain reliability of operations and reduce cost. Against this backdrop, the present high effective import duty of 26.38 per cent (basic rate of 5 per cent, surcharge 10 per cent, CVD 16 per cent and SAD 4 per cent) on plant and machinery imports for the revamp/modernisation of plants is a strong deterrent. This needs to be completely eliminated.

How do we deal with the Indian industry *vis-a- vis* imports? Apart from high feedstock costs to naphtha- and fuel oil-based plants, energy price to even gas-based plants, at about $3 per million Btu, is substantially higher than in exporting countries — less than $1 per million Btu in West Asia. That puts the Indian industry at a significant disadvantage. The need for reasonable protection cannot be over-emphasised.

The Government has not so far declared the bound rate of import duty for urea. This may be reasonably high and should take into account two prime factors: The likely cost of feedstock to plants in India, and the C&F cost of imported urea under the worst possible global demand-supply scenario. Within this overall ceiling, the rate at any point of time can vary, depending on the prevailing domestic cost *vis-a-vis* the import price.

The DAP and other complex phosphatic fertilisers were decontrolled and the RPS covering them withdrawn in August 1992 — and are now covered by a scheme of differential concessional support, under which domestic DAP is given concession at a rate higher than on imported DAP (in the last four years, this has been Rs. 1,000-Rs. 1,500 per tonne). This is with a view to offset the inherent disadvantage domestic units suffer on account of the C&F landed cost of imported phos acid and ammonia being more or, at best, equal to the C&F cost of imported DAP.

The point has been made that the above arrangement is incompatible with India's commitments under the WTO. Considering that the lower concession on imported DAP has the same effect as the import duty, that is, by way of reducing comparative advantage of global suppliers, it would be illogical to treat the former differently from the latter. At the WTO, India should take this line. However, if this is not accepted, there is no alternative but to follow the duty route for providing reasonable production to domestic industry.

Unfortunately, the bound rate of duty on DAP — this was declared long ago — is only 5 per cent. In view of this, though the rate necessary to provide reasonable protection is at least 20-25 per cent, this cannot be levied. Clearly, there is a need to get the bound rate raised before protection through the duty route is possible. The remedy available under the WTO is a long-drawn process (this involves negotiations with INR countries) . Until such time as India succeeds in getting the bound rate raised to a reasonably high level, the Government should take steps to ensure that the present differential concession scheme is continued.

(The author is Chief Economist, Fertiliser Association of India, New Delhi. The views expressed are personal.)