

## *How to make an efficient industry unviable*

By Uttam Gupta

**T**HROUGH the Union Budget for the year 1991-92, the Government decided to impose a ceiling on the subsidy payable to the units producing Single Super Phosphate (SSP) w.e.f. 25th July, 1991. The expressed intention was to enable, as the Finance Minister put it in the Budget Speech, "high cost units to reduce cost and improve efficiency". The measure was also proclaimed to enable a forward move towards total de-regulation.

Although not stated in clear terms, the *raison d'être* in favour of the proposed move was based on the logic that subsidy is used to cover up the inefficiency of the industry. This assumption needs careful scrutiny. SSP is an important fertiliser supplying 16 per cent phosphate and 12 per cent sulphur.  $P_2O_5$  is crucial to the development of the plant roots and helps in ripening process. Sulphur is an important secondary nutrient and its deficiency in large tracts of Indian soil is a matter of great

concern. Government is committed to promote use of SSP to provide these vital nutrients and has taken appropriate steps in the past to achieve this.

Recognising that majority of our farmers are poor and that they are expected to produce foodgrains at low cost, the Government controls the selling prices of all important fertiliser materials at a low level to ensure a reasonably attractive input-output price ratio. SSP is covered by this overall policy dispensation. This price which the farmer is expected to pay, does not fully cover the cost of supplying the material to him. Because of the factor of inflation, the latter is necessarily higher whether the source of supply is through imports or from our own factories. In view of the enormous risk involved in imports, indigenous supply is understandably preferred. Here is a million dollar question. If the producer is called upon to sell at the specified price which is low, the unit can do

the job only at the cost of its viability. The investment can be viable only if there is some one who can make up for the difference between his reasonable cost of production and distribution on the one hand and the price paid by the farmer on the other. It is precisely this difference which is called by the notorious name "subsidy".

The cost of production and distribution has three components i.e. ex-works price, freight and distribution margin. Under the administered price regime, all the three are fixed on a "normative" basis. The ex-works price in particular, is determined on the basis of prescribed efficiency norms for consumption of raw materials, utilities and capacity utilisation. A SSP unit is expected to get 11 per cent post-tax return on net-worth subject to 90 per cent capacity utilisation. While the physical efficiency norms are common to all the units, the ex-works prices can vary from unit to unit

depending on location and vintage.

That should leave no doubt that subsidy is meant to enable supply of SSP at a low price to the farmers. It has no nexus with the so-called inefficiency of any unit which is already penalised under the normative system of pricing. A unit which cannot operate at 90 per cent capacity utilisation, will not be fully recovering its fixed cost including capital related charges and will thus stand to lose. Conversely, if it can do better than 90 per cent, it has a chance of earning reasonable profits. So long as the Government itself decides what a unit should get, for which there is a prescribed efficiency oriented formula, the question of a further limit on that is illogical and meaningless. In fact, it is even contrary to the basic principles of jurisprudence. And, for that very reason some of the affected manufacturers have even challenged the Constitutional validity of ceiling in the Court of Law. The serious ramifications of the ceiling require

due attention.

The relevant notification prescribing the ceiling on subsidy came on 1st November, 1991. The ceiling was fixed at Rs. 890/- per tonne relating it to the cost structure as represented by the ex-works price for the quarter ending 30th September, 1990. At this level and considering the selling price at 1240/- per tonne (after 30 per cent increase), the maximum entitlement of any unit was thus Rs. 2130/- (890 + 1240). In respect of as many as 22 units, the reasonable cost of production and distribution (notified ex-works price + equated freight + distribution margin), was higher than this figure of 2130. In other words, introduction of the ceiling made as many as 22 units unviable. This would mean an annual production loss of about 1.407 million tonne and to make up this loss, equivalent import of 0.4894 million tonne DAP (1.407 x 0.16/0.46) would be necessary. Consequential foreign exchange outgo on this will work out to

US \$ 95.4 million (taking current C&F cost of DAP at US \$ 195 per tonne). Even after adjusting for the saving on import of rock and sulphur which is \$ 61.83 million (1.407 x 0.57 x 60 x 1.407 x 0.125 x 78), the net additional foreign exchange outgo will be \$ 33.6 million.

As against this heavy price in terms of additional foreign exchange outgo, the savings in subsidy because of the ceiling works out to only about Rs. 13 crore. That much savings could have been easily achieved by raising the selling price of SSP by a further Rs. 40 per tonne (3.6x40 = Rs. 14.4 crore, 3.6 million tonne being the production of SSP in 1990-91). This is reasonably justified also purely on the strength of the nutrients in supplies i.e. 16 per cent  $P_2O_5$  and 12 per cent sulphur. Take for instance, the value of 1 kg  $P_2O_5$  thru DAP at its current selling price i.e. Rs. 7.57. Multiply by 160 and we get Rs. 1,211.2..

(To be continued)