Editorial

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Ballooning fertiliser subsidy

Is the real culprit going scot-free?

Government undertakings, particularly in the petroleum and gas sector, get accolades for their impressive financial performance, even as the fertiliser industry is made a scapegoat for the rising subsidy bill. Continuing to expect the industry and the farmers to bear the brunt of reduced subsidies while ignoring the real cause behind their phenomenal increase will have a debilitating effect on foodgrains production, says Uttam Gupta.

THE 1999-2000 Budget provided Rs. 13,250 crores for fertiliser subsidy. This included Rs. 8,000 crores on domestic urea, Rs. 750 crores on imported urea, and Rs. 4,500 crores on P and K. Against these, the revised estimate (RE) for subsidy on domestic urea is higher by Rs. 670 crores, but lower by an equivalent amount on imported urea. In view of this, and the RE for P and K fertilisers remaining unchanged at the budgeted level, the overall RE for subsidy in 1999-2000 was Rs. 13,250 crores.

Based on the cost structure at the beginning of the year and taking into account the likely impact of both the steep increase in prices of various hydrocarbons — about Rs. 2,000 crores — and the retrospective revision in conversion charges for 1997-98 and 1998-99 under the retention pricing scheme (RPS), the actual requirement for subsidy on domestic urea in 1999-2000 is put at Rs. 10,000 crores. Against this, the RE being Rs. 8,670 crores, there is a shortfall of about Rs. 1,300 crores.

For decontrolled P and K fertilisers, based on the concession rates notified for kharif 1999 — Rs. 4,600 per tonne on domestic DAP (proportionate basis for other complexes) and estimated sales, the requirement for concession support in 1999- 2000 — including carry-forward from 1998-99 — is expected to be about Rs. 6,000 crores. The corresponding RE is Rs. 4,500 crores, leaving a gap of about Rs. 1,500 crores.

For domestic urea and decontrolled P and K fertilisers — both put together — the budgetary allocations for 1999-2000 would, thus, have left an uncovered gap of about Rs. 2,800 crores. This would necessarily have to come out of allocations in 2000-01. The impact of revision in conversion charges for 1999- 2000 under RPS for urea must also be considered. The total carry forward would, thus, be about Rs. 3,500 crores.

In 2000-01, based on the prevailing cost structure and selling price (before the 15 per cent hike in the Budget), the requirement for subsidy on domestic urea is expected to be about Rs. 9,000 crores. For P and K fertilisers, based on the prevailing concession rates and the selling price (before the hikes proposed in the Budget), this would be about Rs. 5,500 crores. Together with a throw-forward of about Rs. 3,500 crores and the outgo on imported urea of Rs. 500 crores, the total requirement would be about Rs. 18,500 crores.

Against this, the Budget allocation in 2000-01 of Rs. 8,058 crores on domestic urea, Rs. 4,093 crores on decontrolled P and K fertilisers, and Rs. 500 crores on imported urea total Rs. 12,651 crores. This is about Rs. 6,000 crores lower than the likely requirement. It is, therefore, not surprising that some recent reports referred to the Government's proposed move to bring about subsidy savings of this magnitude.

Already, the selling price of various fertilisers has been hiked — urea by 15 per cent, DAP 7 per cent and MoP 15 per cent. In absolute terms, these work out to Rs. 600 per tonne of urea, Rs. 600 per tonne of DAP (proportionate increases in the prices of other complex fertilisers) and Rs. 555 per tonne of MOP. While, an increase in urea price will yield about Rs. 1,200 crores per annum, savings generated from the hike in prices of decontrolled P and K fertilisers will be about Rs. 800 crores. Overall, thus, there will be savings of about Rs. 2,000 crores.

Second, before the Budget, the Government was reportedly contemplating removal of distribution controls on urea and concomitant withdrawal of subsidy support towards freight and distribution margin. Denial of these costs on decontrolled P and K fertilisers — while determining/fixing concession rates — was also mooted. Though no mention was made in Mr. Yashwant Sinha's speech, recent reports do not rule out such a possibility. In that event, there is scope for savings of about Rs. 2,000 crores on all fertilisers.

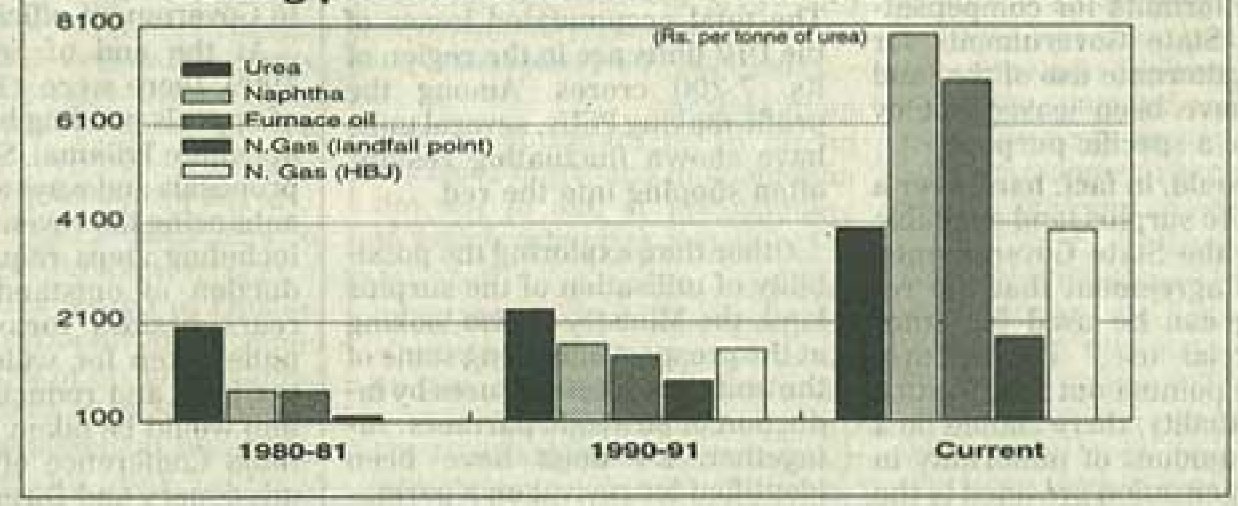
Third, the Finance Minister's speech hinted at rationalisation in the RPS for urea, including the capping of capital-related charges (CRC). Further, in a post-Budget discussion, the Secretary (Expenditure) spoke about a ceiling of 100 per cent capacity utilisation. Besides, allocations for kharif 2000 have been restricted to a certain determined percentage of plant production at optimum level. While these measures are expected to lead to significant savings, it remains to be seen if they will yield another Rs. 2,000 crores to reach the overall target of about Rs. 6,000 crores!

The increase in the selling price, particularly urea, has led to a spate of protests and even demands for a rollback. It is important, here, to assess the precise impact. On a per bag (50 kg) basis, price increases translate to Rs. 30 for urea, Rs. 30 for DAP and Rs. 28 for MoP. Taking the average use for one hectare as four bags of urea, two bags of DAP and one bag of MoP, the farmer will have to fork out an additional about Rs. 208. In turn, this will increase the production cost of foodgrains by about Rs. 14 per quintal (assuming an average yield of 15 quintals per hectare).

Whereas for farmers with marketable surpluses, this can be offset by a corresponding hike in the procurement price, those who produce primarily for self-consumption will feel the pinch. Of a total of 106 million farm households, about 75 per cent are small and marginal, that is, with a holding size of 1-2 hectare and 0-1 hectare, respectively. Within this, while, there may be farmers producing surplus (they may have access to irrigation and other vital infrastructure), the majority are in the subsistence category. Efforts are needed to mitigate their hardships, in case the price hikes stay.

As for the withdrawal of subsidy support to freight and distribution, it is not clear who will pay these costs. As a matter of convention, whenever distribution controls are lifted, producers/suppliers are expected to mark up the ex-factory price to include the freight and distribution cost to arrive at selling price. These costs being about Rs. 600 per tonne urea, on an average, farmers will have to pay that much more. Together with the increase in the notified price of Rs. 600 per tonne, the total additional burden on farmers will be about Rs. 1,200 per tonne.

Selling price of urea vis-a-vis cost of feedstock



Alternatively, the possibility of manufacturers/suppliers being called upon to absorb the freight and distribution cost is also not ruled out (as it is, the 15 per cent hike has evoked widespread resentment which will be difficult to contain if farmers are required to bear an additional 15 per cent). In such an event, the bottom-lines of fertiliser companies will come under unprecedented stress. The logical efforts to shuffle their marketing territories — in a bid to contain outgo on distribution cost — could also affect supplies, particularly in remote/inaccessible areas.

The margins of urea manufacturers could also be affected by the proposed rationalisation of the RPS, in particular the capping of CRC. For decontrolled P and K fertilisers, the indication in Mr. Sinha's speech that the reduction in concession will be much more than the increase in their selling prices is a cause for concern.

The producers' margins will come under pressure if the difference between the two is not fully absorbed by the downward adjustment in the prices of imported raw materials such as phos acid and ammonia.

From the above, it is clear that both the farmers and the fertiliser industry are being made to bear the brunt of the proposed subsidy reduction. In doing so, the Government seems to be completely unaware of the fact that subsidy has increased primarily on account of the steep increase in the prices of inputs — particularly, feedstock, utilities such as power and water and services, and railway freight apart from the cascading impact. The following numbers will help gauge the magnitude of the effect of various taxes and duties. Between 1980-81 and 1999-2000, the steep increase in prices of various hydrocarbons such as naphtha, fuel oil, LSHS and gas, alone contributed to a cost push of about Rs. 9,600 crores. During this period, the increase in selling price of urea generated an extra realisation of about Rs. 3,300 crores.

After offsetting this, there was an uncovered gap of Rs. 6,300 crores which had to be met by increased subsidy support.

The increases were particularly sharp in recent years. For instance, the increase in hydrocarbon prices in September/October 1997 — following the switchover to pricing on the basis of import parity principle (IMPP) — led to an increase in cost and, in turn, the subsidy outgo rose by about Rs. 1,500 crores per annum. Likewise, in 1999-2000, the steep increase in their prices resulted in a subsidy hike of about Rs. 2000 crores.

It is important to note that increases in the cost of raw materials/utilities and freight lead to corresponding increases in the surpluses of corporations/agencies owned and controlled by the government, including ONGC, IOC, OIL, GAIL, SEBs and the Railways. The consequent jump in the fertiliser subsidy is not a net burden on the exchequer. It is a mere intra- economy transfer from the Budget head to these corporations/agencies.

Even as there is a hue and cry about the ballooning fertiliser subsidy bill, government undertakings, particularly in the petroleum and gas sector, keep making high profits, as there is no question of their subsidising the cost of inputs sold to fertiliser companies. For instance, ONGC posted a profit of about Rs. 2,700 crores in 1998-99, and Rs. 3,500 crores in 1999-2000. This gives rise to a highly anomalous situation, where, even as these undertakings get accolades for their impressive financial performance, the fertiliser industry is made a scapegoat for the rising subsidy bill.

Continuing to expect the industry and the farmers alone to bear the brunt of the reduced subsidies while ignoring the real cause behind its phenomenal increase will have a debilitating effect on fertiliser production/consumption and, in turn, foodgrains production.

There will be a serious threat to the country's food security, so painstakingly built over the last three decades. The impact on overall agricultural growth and, in turn, on the economy as a whole, cannot also be wished away. The mindset has to change before it is too late.

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