THE HINDU BUSINESS LINE

16 May, 1995

Fertiliser imbroglio — I

Looking beyond the subsidy maze

The budgetary provision for 1995-96 appears to be more or less adequate to meet the anticipated fertiliser subsidy component during the year. This is, however, on the assumption that the prevailing cost structure will continue. Any rise in costs — in particular, the administered prices of the hydrocarbon feedstock and power — may lead to a further increase in the subsidy requirements, says Uttam Gupta.

THE year 1994-95 has been particularly satisfactory from the viewpoint of availability of funds for fertiliser subsidy in relation to the requirements, even though timely disbursement to the manufacturers continued to be a matter of some concern. The Budget for 1994-95, had provided for an allocation of Rs. 4,000 crores, Rs. 3,500 crores as subsidy on domestic fertilisers (mainly urea) and Rs. 500 crores on imported material. At the prevailing cost structure and the controlled selling price of urea, this amount was more or less adequate to meet the requirements.

With effect from June 10, 1994, the urea selling price was raised by 20 per cent i. e. an increase of Rs. 552 per tonne thereby facilitating reduction in subsidy requirement by about Rs. 800 crores corresponding to the quantum of material sold during the period of about 10 months up to March 31, 1995. However, consequent to the announcement of the revised retention prices due to adjustment under sixth pricing commencing April 1, 1991, there was an additional subsidy liability of about Rs. 1,200 crores for the four year period i. e. 1991-92 to 1994-95. Eventually, there was a net increase in subsidy requirement by about Rs. 400 crores.

Considering that the revised Budget estimate for subsidy on domestic material during 1994-95 at Rs. 4,000 crores is higher by Rs. 500 crores, the increased requirement has been more or less fully accommodated. In fact, there would be a surplus of about Rs. 100 crores which could be utilised for meeting some further escalation in input and freight cost, not reflected, as yet, in the retention prices.

The revised Budget estimate for subsidy on imported urea for 1994-95 has been placed at Rs. 1,166 crores which is Rs. 666 crores higher than the Budget estimate of Rs. 500 crores. Considering that the quantum of urea imports during the year at about three million tonnes were more or less maintained at previous years' level, the increase in subsidy was primarily on account of the substantial increase in the international price of urea.

The budgetary provision for 1995-96 i. e. Rs. 3,750 crores on domestic production and Rs. 1,650 crores on imported material, making for a total allocation of Rs. 5,400 crores, appears to be more or less adequate to meet the anticipated requirements of fertiliser subsidy during the year. This is however, on the assumption that the prevailing cost structure will continue; any rise in the cost, particularly the administered prices of hydrocarbon feedstock and power etc., may lead to further increase in the requirements.

Availability of ad hoc concession for decontrolled phosphatic and potassic fertilisers has however, been a problem area. The revised Budget estimate for 1994-95 has been placed at Rs. 517 crores. This represents a shortfall of about Rs. 200 crores vis-a-vis the actual requirement based on the estimated despatches and the rates of concession notified by the Government. Likewise, the budgetary provision of Rs. 500 crores during 1995-96, even at the rates applicable to 1994-95, may turn out to be inadequate if 1994-95 consumption levels have to be maintained. Including the carry-forward from the previous year of about Rs. 200 crores, the total shortfall during 1995-96 would be well above Rs. 400 crores. Increase in consumption would necessitate additional funds.

Meanwhile, the international prices of imported raw materials and intermediates have increased further and if further rise in selling price to the farmers and resultant slide in consumption of these fertiliser has to be prevented, there is no other way, but, to increase the subsidy rates. During Rabi 1994-95, at the C&F landed cost of phos acid and ammonia at $373 per tonne and $220 per tonne respectively, the reasonable farmgate cost of domestically produced DAP was about Rs. 9,500 per tonne, and with a subsidy of Rs. 1,000 per tonne, the selling price to the farmer was about Rs. 8,500 per tonne. At this level, consumption of DAP failed to come up. Since then, C&F landed cost of phos acid and ammonia have already increased to $411 and $250 per tonne respectively. Consequential increase in the cost of production of DAP by about Rs. 800 per tonne will require corresponding increase in concession amount. Failing this, the possibility of a serious adverse effect on consumption is not ruled out.

Notwithstanding some shortfall in phosphate, the increase in allocation of fund for fertiliser subsidy would seem to give an impression that the problems of the fertilisers sector have eased substantially; that, with the political leadership now categorically stating its intention to continue with subsidy regimes specially for food and fertilisers, there are better days ahead. This is far from correct. The reasons are primarily two fold.

First, even assuming that subsidy provides succour to all the problems of the fertiliser industry (which is not the case), it will be a grave mistake to go by the present mood of the political leadership. It is too good to believe that having stated its commitment to subsidy now, the political leadership will stick to it. In fact, only a few years back when the reform process started in July 1991, the mood was just the opposite. In the economic memoranda submitted to the IMF then, the Government had promised to eliminate fertiliser subsidy by the end of 1993-94.

Presently, the Government is under no pressure to reduce, not to talk of eliminating subsidy. This is because we have built up huge foreign exchange reserves. We do not need IMF assistance at this stage. Consequently, there is no question of the latter insisting on its conditionalities, one of which, it goes without saying, has been the subsidy reduction and its eventual elimination.

The Government has sought to lend legitimacy to its changed focus in terms of another circumstances. Our aggregate measurement support for agriculture which includes product and non-product specific subsidies, is less than 10 per cent (despite increasing in recent years), and consequently, in terms of the World Trade Agreement (WTA), we are free from the subsidy reduction obligation. However, there is nothing new in this, as what was contemplated in the proposed WTA was known to us even way back in 1991, when the Government took the pledge to eventually eliminate fertiliser subsidy. It is therefore irrelevant and is only being used as a convenient tool to drive us away from the paramount need to deal with the essentials, in as much as the bulging foreign exchange reserves have made the Government complacent on the macro-economic reforms.

The IMF conditionality factor which, for the time being, has taken a back seat, is bound to surface again. This is because our economic fundamentals continue to remain weak nor has the Government demonstrated any seriousness to effectively deal with them. We run the risk of plunging into a balance of payment crisis for which we will have to fall back on the IMF and the World Bank. Inevitably, the present pro-subsidy mood will give way to anti-subsidy drive.

Second, the generic problems in the fertiliser sector lie elsewhere and unless these are addressed, continuation of the subsidy regime even with provision for yearly enhancement alone will be of no help. The proof of the pudding is in eating. In this connection, it is pertinent to note that almost immediately after the decontrol of phosphatic and potassic fertilisers in August 1992, subsidy was brought back, though under a new name i. e. "ad hoc concessions". This arrangement was in operation until the end of 1994-95 and has been continued even during the current year i. e 1995-96. Notwithstanding this, it has not been possible to stem the declining trend in their consumption particularly phosphatic fertilisers even as the imbalance in the NPK use continues to deteriorate. Except for making a passing reference in the Economic Survey for 1994-95, the Government has not announced any policy initiative to retrieve the situation.

For production of phosphatic fertilisers, the basic QA raw materials are rock phosphate and sulphur. Whereas in respect of the latter, India is entirely dependent on imports and as for the former, the domestic availability can support a meagre 10 per cent of production. Of the total installed capacity of about 2.8 million tonnes P205, bulk is based on imported phos acid and ammonia (the former being an intermediate product made out of reactions involving rock phosphate and sulphur). These principal intermediates alone make up for about 80-85 per cent of the total cost of production of GAP. This is how the domestic industry becomes potentially vulnerable and subsidy/concessions is at best a temporary reprieve.

The international prices of phos acid and ammonia are highly volatile. Having reached a particular level, there is no guarantee that these would stabilise. Much depends on the global demand-supply situation. Presently, the conditions are tight and they will continue to remain so. Particularly, with China importing on a large scale and increase in acreage under cultivation in the US leading to increased domestic demand.

That apart, the supplies are cartelised and prices are subject to manipulation. Against this backdrop, the possibility of suppliers taking advantage of the concession announced by the Government or an increase in the amount, is also not ruled out. Prices may go up still further, nullifying the very objective of subsidy. This is how the concession amount of Rs. 1,000 per tonne DAP, which was more or less adequate in Rabi 1994-95, is no longer sufficient in Kharif 1995. Even assuming that the amount is raised by about Rs. 800 per tonne for the current season, what is the guarantee that the augmented amount of Rs. 1,800 tonne will prove sufficient for the next season.

(To be concluded)

(The author is Chief Economist of the Fertiliser Association of India, New Delhi.)