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Misguided plea

Higher production cost resulting from price preference increases the subsidy burden, says **Uttam Gupta**

THE Confederation of Indian Industry (CII) has represented to the government seeking restoration of the 15 per cent price preference ı the domestic manufacturers/supıliers of plant, machinery and equipıent to fertiliser projects. The proısal has serious implications for ıe fertiliser industry which is already ıhting a grim battle for its survival ıe to sudden decontrol of P and K rtilisers and various distortions in e administration of retention pricing heme (RPS) for urea.

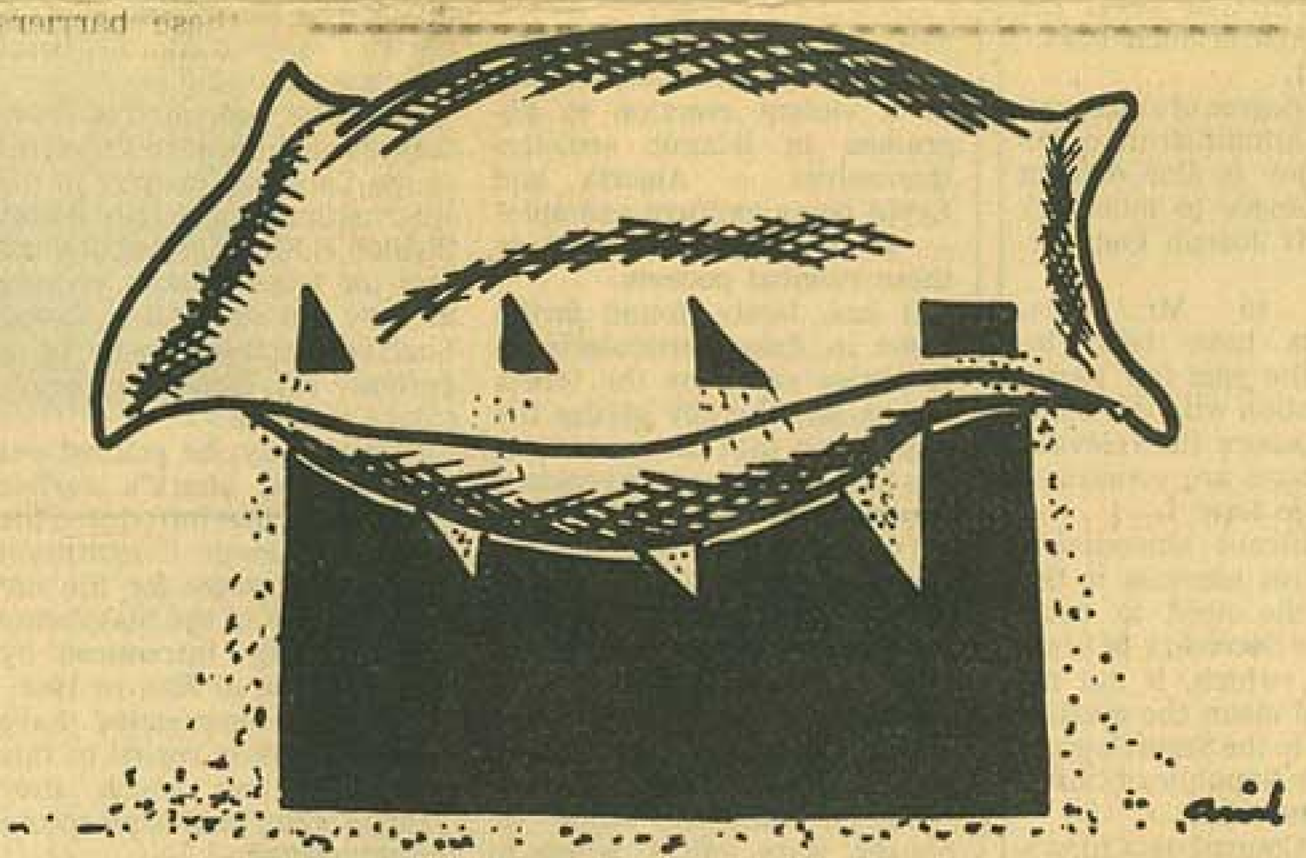
Way back in 1986, based on the commendations of the Committee Secretaries (COS) the government corded a price preference of 15 per ınt to the domestic suppliers of ıpital goods for the purpose of valuating global tenders under the ꞏB (international competitive bidıng) procedure. While this was ıtended to offset the inherent cost sadvantage suffered by the domestic anufacturers vis-a-vis the foreign ıppliers, it had an unavoidable adırse effect on the fertiliser industry. ı the extent, suppliers were sourced om the domestic industry, this led an increase in the project cost ıd, in turn higher cost of production ıe to consequential capital servicing arges.

Amongst the projects affected by is special dispensation given to the mestic capital goods industry inıded Nagarjuna Fertilisers, Kakinda 92), Chambal Fertilisers, Kota ınuary 1994) Tata Chemicals, ıbrala (December 1994) and Oswal ıemicals, Shahajahanpur (Novemr 1995). Expect Nagarjuna, the maining three are along the HBJ ıeline. Three more projects along HBJ i e NFL, Bijapur, IFFCO, nla and Indo-Gulf, Jagdishpur comssioned during 1987-88 narrowly ıaped as they had completed proıement of their needs before the ce preference came into effect.

Because of the control on the ling price of fertilisers at a low el to induce increasing consumpı for subserving the overall food urity goal, under the RPS, the ess of the reasonable cost of duction and distribution over this reimbursed as subsidy to the nufacturers. In view of this, the her cost of production resulting m the price preference led to responding increase in the subsidy rden on the exchequer.

Whereas in respect of urea, the position continued even into the 90s, the manufacturers of phosphatic fertilisers had to suffer due to sudden decontrol in August 1992, and withdrawal of subsidy support under the RPS.

Although subsidy was re-introduced as ad hoc concession, this being a flat rate applicable to all units e g DAP Rs 1000 per tonne (revised to Rs 3000 w e f July 6 1996), does not take care of the additional cost of projects affected by the price preference. These include the likes of Godavari Fertilises, Kakinada and PPL, Paradeep which



were commissioned after 1986.

With a view to keep subsidy under check, as in the case of urea, and maintain the selling prices of decontrolled phosphatic fertilisers at reasonable levels, in May 1995, the government decided to discontinue this facility. This was not an isolated development. It was, in fact, the culmination of a series of steps taken, in the early 90s, aimed at reducing the cost of fertilisers.

Amongst others, these included removal of customs duty of fertiliser project imports and on imports of plant and machinery for rehabilitation of existing plants w e f September 23 1992. To help the phosphatic industry, the customs duty on imported phosphoric acid, one of the principal intermediates used in production of P fertilisers, was eliminated w e f August 27 1992.

While pursuing the overall macroeconomic objectives, the government also implemented appropriate measures to ensure that the health and growth of the domestic capital goods industry is not adversely affected. This was amply reflected in its decision, in early 90s, to grant deemed export status to the supplies made by the domestic manufacturers to fertiliser projects.

The deemed status entitles the domestic suppliers of plant and machinery to duty free import of raw materials, exemption from payment of excise duty and reimbursement of cash compensatory benefits. Needless to say that by facilitating reduction in the cost of production, these concessions have helped the domestic suppliers of capital goods in improving their competitive edge.

That the capital goods industry continues to perform well is demonstrated by growth in production of 18.2 per cent during April to September 1996 over April to September 1995. This is against a growth of 14.0 per cent during April-September 1995 over the corresponding period of 1994. The impressive performance of this sector during the current year is in sharp contrast to the slow-down in majority of other industries including fertilisers.

As per some recent press reports, the domestic manufacturers have a cost disadvantage vis-a-vis foreign suppliers mainly due to high financing cost, levy of central sales tax (CST) and a variety of local taxes including sales tax, turnover tax etc. These problems are not peculiar to the capital goods industry alone; in fact, they are common to all the industries including fertilisers. These need to be tackled right at the source instead of seeking protection by way of price preference which will have serious adverse repercussions on the fertiliser industry.

In the context of fertilisers for instance, with a view to lowering the cost of production and improve the competitiveness of the domestic industry, in February 1993, the government allowed a maximum concession of 3 per cent in the interest payable on long term loans raised by new fertiliser projects (commissioned on or after April 1 1991) from financial institutions.

Additionally, the projects were also given the facility of refund of customs duty including auxiliary and countervailing duty (CVD) paid on import of capital goods during January 1 1988 to September 23 1992. Since September 23 1992, as mentioned earlier, no duty is being charged on fertiliser project imports and imports of plant and machinery for revamping rehabilitation of existing units.

For the domestic capital goods industry, considering that the disadvantage on account of the higher financing charges alone is about 50 per cent of the overall disadvantages, the proper course would be to seek relief by way of lowering of the inherent rate. The industry should also take advantage of the liberalisation rules in respect of external commercial borrowings (CEB) to tap cheaper funds from abroad.

The state taxes and duties account for a significant share of the overall cost. While increasing revenues is their prime concern, the state governments should recognise that introduction of multiple levies and increasing the rates do not necessarily help in achieving this objective. They should shed this approach and stress efficient administration and better tax compliance for increasing collections. The government should act as a facilitator in this process.