RPS is not WTO-incompatible

Uttam Gupta

CONSEQUENT to the recent ruling of the WTO panel disallowing the continuation of quantitative restrictions under BoP cover, the Government has committed to remove all QRs by April 2001. In the fertiliser sector, even as imports of all P and K fertilisers is freely permitted, urea too may have to be decanalised and made freely importable. The implications of this on the domestic policy environment needs to be assessed carefully.

Currently, urea is covered by the Retention Price Scheme (RPS), where even as the selling price is controlled at a low and uniform level — to induce increase in consumption — the excess over the reasonable cost of production and distribution is reimbursed as subsidy to the manufacturer. The scheme is unit- specific as production cost varies due to differences in feedstock, location, vintage and so on. For imported urea, the excess of the farmgate cost (C and F price plus port-handling and distribution cost) over the selling price is subsidised.

Considering the overriding importance of food security and the role of fertilisers in increasing production of foodgrains, it can be safely surmised that the selling price of urea will continue to be controlled at a low level, unrelated to the cost of supply. Further, this price will be uniform, irrespective of the source. Thus, imported urea will sell at the same price as the domestic product. Needless to say, there will be no restriction on the quantum of imports.

The realisation from sale at controlled prices being lower than the reasonable cost of supply, the domestic producer will be subsidised for the difference under the RPS. The importer, too, will be fully subsidised for the excess of C and F cost plus handling and distribution, over the selling price. Thus, both being treated on a par, there is no question of any unfairness or discrimination.

A look at the numbers may cause some comment though. At the prevailing C and F cost ($100 per tonne), the farmgate cost of imported urea is about Rs. 5,500 per tonne. Against this, the weighted average cost for domestic producers is about Rs. 8,500 per tonne. The sale price being common (Rs. 4,000 per tonne), this would involve providing higher subsidies to domestic industry — Rs. 3,000 per tonne. However, it would be improper to formulate a view in isolation merely on the basis of the existing situation.

Currently, international prices of urea are depressed as China is absent from the world market and India's imports are small. As and when imports rise, prices too will, as in 1995-96 and 1996-97. Then, the cost of supplying imported urea could be higher than weighted average cost of supply from domestic industry. The latter would have reason to be up in arms against the former!

It may also be noted that the production cost of the domestic industry is high primarily because of the high cost of feedstock — about $3 per million BTU for gas-based plants along the HBJ pipeline and $7-8 per million BTU for naphtha-based plants as against less than $1 per million BTU for plants in West Asia — besides the cascading effect of taxes and duties over which it has no control. If only the cost of feedstock is brought down to internationally-comparable levels, Indian industry can supply

urea at costs lower than the material imported now.

In view of this, the contention that continuation of the RPS is tantamount to discrimination against imports is illogical and unsustainable. The RPS is essentially an instrument of achieving the overall macro-economic goal of food security. After all, even developed countries run agricultural support programmes and give away subsidies several times that in India. It would be unfair to take a view in isolation.

The extent of subsidy support to agriculture — both product- as well as non-product-specific — is covered separately under the Agreement on Agriculture. The AoA provides for reduction commitments if the subsidy level as a percentage of agricultural production exceeds 5 per cent for developed countries and 10 per cent for developing countries.

Given that the subsidy support in India is already negative, we are exempt from undertaking any reduction commitments. The subsidy under the RPS is included in computing the aggregate measure of support (AMS). In view of this, as long as the AMS continues to be lower than *de minimus* 10 per cent level, continuation of the RPS should not be construed as WTO incompatible.

Among the various misconceptions about the RPS — there have been several and not only caused controversies but, even result in adverse policy changes in the 1990s — a prominent one is that the fertiliser subsidy under this system accrues to the manufacturers. It does not. The subsidies facilitate the sale of fertilisers to farmers at a price below the reasonable cost of supply and, therefore, accrues to the farmers. Moreover, considering that the cost of fertilisers is reflected in the procurement price of foodgrains, the subsidy essentially accrues to the consumer.

The subsidy, routed through industry for ease of administration, cost-effectiveness and to lessen the scope for misuse, is administered by the FICC (of the Department of Fertilisers) which disburses large amounts (Rs. 8,000 crores being the Budget provision for subsidy on domestic urea in 1999- 2000) to manufacturing units based on comprehensive/exhaustive calculations of retention prices using predetermined guidelines/parameters. The money spent on the FICC Secretariat is a negligible cost to the exchequer.

Against the existing system, consider the alternative of the subsidy being given directly to the farmers. There are 106 million farm households across the country. Even assuming that a farmer buys urea once each season (kharif and rabi), there would be a total of 212 million purchases. Subsidising these sales directly is an unimaginably complex exercise. Certainly an impossible one once we consider the poor infrastructure in the States.

Some argue that subsidies need not be given to the rich farmers. There has been a debate about how to determine who deserves the subsidy. Going by the criterion adopted in 1991-92 — small and marginal farmers, that is, with land-holdings in 1-2 hectare and 0-1 hectare were considered poor — for exemption from the 30 per cent increase in selling price, the poor farmers are 75 per cent of the total. In other words, even if the subsidy is limited to the poor farmers, the number of sales to be covered would still be 165 millions.

That a system of direct subsidisation does not work is vindicated by the failure of the scheme for which a separate allocation of Rs. 450 crores was provided in the Budget; the money was distributed among the States in proportion to the consumption of fertilisers by small and marginal farmers and the Government admitted that only 3.5 per cent of the target farmers benefited from the scheme.

When the Government introduced a scheme of concessional support to all decontrolled P and K fertilisers in October 1992, and sought its direct administration by the States, the latter did not take on this responsibility; instead, they depended on the producers to disburse the subsidy to the farmers. At present, even as the Government disburses funds, based on certification by the States, to the farmers, these reach them through industry. It is also pertinent that in their submission to the High-Powered Hanumantha Rao Committee (1998), the State governments had expressed their inability to administer schemes for giving subsidies directly to the farmers.

In view of this, it is clear that even as the fertiliser subsidy is routed through industry for ease of administration and cost-effectiveness, the benefit accrues entirely to farmers and consumers of foodgrains. This fact must be emphasised as there is the risk of the fertiliser subsidy being perceived as an issue relating to industry (as understood conventionally) and the consequential denial of the potential benefits, under the AoA.

This would also enable better appreciation of the role of RPS and its pioneering contribution to food security and overall agricultural development. In turn, this would help prevent such precipitate steps as sudden decontrol of urea/dismantling of the RPS as happened for P and K fertilisers. Instead of getting carried away by the liberalisation euphoria, the need of the hour is to learn from experience.

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