31 December, 2003
THE HINDU BUSINESS LINE

Fertiliser subsidy

The hassles of payment on sales

UTTAM GUPTA

THE Department of Fertilisers in the Ministry of Chemicals and Fertilisers — the nodal authority for laying down procedures for administration of the New Pricing Scheme for urea manufacturing units — is thinking of switching over to a system of subsidy payment on actual sale of the product from the existing practice of payment on dispatch.

The pros and cons of the move need to be carefully examined.

At present, at the end of each month, the manufacturer submits a claim for reimbursement of subsidy on the quantity of urea produced and dispatched during the month.

The subsidy amount is equal to the difference between the concession rate (read ex-factory price) applicable to the unit and the realisation from sale at the selling price (also fixed by the Government) multiplied by the quantum of production/dispatch.

Unlike a manufacturer operating in a free market environment who gets the full realisation (this is equal to the market price as no subsidy is involved here) only after the product has actually been sold, a urea producer realises a portion of the production cost — represented by subsidy — within a defined period (generally within 60 days of the submission of the bill as per the Gazette Notification published in November 1977).

The demand for urea is highly seasonal with bulk of consumption taking place in four months (July and August during kharif and November and December during rabi). And since production is continuous throughout the year, were the entire realisation to come only after the sale is effected, there would be a mismatch between the cash inflows and outflows.

Against this backdrop, payment of subsidy that represents a significant share of production cost within two months from close of the relevant month results in generation of the required cash, thereby enabling the manufacturer to pay the suppliers of raw materials and other inputs in time. This, in turn, helps maintain uninterrupted production.

For plants that use naphtha, fuel-oil/LSHS (low sulphur heavy stock) and mixed feedstock (gas-based plants using alternate feedstock by more than 25 per cent of the total energy requirements), the cost of production and, in turn, subsidy component in total realisation is high, primarily due to the significantly higher cost of these inputs *vis-à-vis* natural gas. Consequently, the payment of subsidy on dispatch is even more crucial for these plants.

The above system has been in vogue refer to DAP/complex fertilisers, where the system of payment on sales has been in place for more than 10 years.

Prior to August 25, 1992 all phosphate fertilisers were under pricing and distribution controls and covered by RPS. As in urea, the manufacturers were paid subsidy on dispatch. From August 25, 1992 these fertilisers were decontrolled and the RPS cover withdrawn. From October 1, 1992 the Government re-introduced subsidy under its new incarnation, called ad hoc concession (the prefix 'ad hoc' was subsequently dropped).

Under the concession support scheme, the Government gave States the money for direct disbursement to the farmers. As the States were not equipped to carry out this job on their own, they took the help of manufacturers. Under arrangements put in place by the former, the latter sold fertilisers to farmers at the notified price and were paid subsidy on producing evidence of sale at that price.

The above payments of concession to manufacturers were on actual sales, as against the earlier RPS regime of payments on dispatch. From April 1, 1994 onwards, the Government started making the payments directly to the manufacturers (as several State governments were found diverting the money for other uses) but only after receiving the certificates from the States.

Until March 31, 1997 the Government was paying 100 per cent of concession amount only after receiving certificates from the States. From April 1, 1997 it provided for the payment of 80 per cent concession as 'On Account' and subsequently raised this amount to 85 per cent (90 per cent in case the manufacturer furnished bank guarantee for the differential amount). These arrangements continue till date.

How does the scenario for urea compare with that of DAP/complexes? Before April 1, 2003 (drastic changes in the policy dispensation for urea were introduced from this date), there was control on the selling price of urea as well as DAP/complexes.

And since the price was lower than the cost of production and distribution

After removal of controls, the Centre relies on a certificate from the States concerned to ensure that the fertiliser on which subsidy is claimed on dispatch has actually been sold to farmers at the notified price. But, often, this certificate is delayed, and the manufacturer's finances are hit. Making payments directly to farmers may be a way out.

From April 1, 2002, for complex fertilisers, the uniform concession for all plants was replaced by a two-part concession scheme. There were separate concession for plants (i) based on imported ammonia and domestic ammonia made from gas, and (ii) plants using ammonia made from naphtha/fuel oil. From April 1, 2003, the unit-wise RPS for urea manufacturers has been replaced by a group- based concession scheme (groups classified according to feedstock and vintage). In view of this and the manufacturers of DAP and other complex fertilisers, also under a group-based concession scheme, the essential features of pricing for the two sectors are thus similar.

Prior to April 1, 2003 a major point of difference related to distribution. While urea was covered by a comprehensive system of distribution controls that involved State-wise allocation of quantities for sale and its continuous monitoring and surveillance by the Government with back-up support from the States, there was no control on sale and distribution of DAP/complexes.

From April 1, 2003, the Government lifted controls on distribution to the extent of 25 per cent during kharif 2003 and 50 per cent during rabi 2003-04. It also hinted at the possibility of completely dismantling the controls from April 1, 2004.

The Union Minister for Chemicals and Fertilisers reiterated this while inaugurating the FAI (Fertiliser Association of India) Annual Conference on December 4, 2003.

In the above scenario, dispensation for urea will be at par with that for DAP/complexes. And since, for the latter, the system of payment on actual sale is already in vogue, the Government has been prompted to adopt the same course for the former as well.

Clearly, the freedom of sale — partial this year and contemplated full freedom from April 1, 2004 — is the trigger point.

As long as the Government exercised full control, it was automatically presumed that the product on which subsidy is claimed on dispatch has actually been sold to the farmers at the notified price. But, after removal of the concerned State) at the point of sale. In other words, the subsidy payment will have to be linked to actual sale.

Then, to continue with payment on dispatch will go against the very logic of seeking verification at the sale point. The two do not go together!

In view of above, the Department of Fertilisers may have a rationale for introducing the system of payment on actual sale for urea. However, it should not ignore the operating environment in which it has to be implemented. Specifically, it should take note of the nightmarish experience that producers of DAP/complexes have undergone under this system.

The crux of the problem is that the States do not send certificates within the prescribed time limit (in States such as Bihar, these do not reach the Centre for years). As a result, huge amounts remain blocked as subsidy arrears. Under such circumstances, it is virtually impossible for manufacturers to carry on production apart from loss of interest, which dents profit margins.

In the recent past, the Government has even initiated proceedings against manufacturers for recovery of On Account payments already made. While acting in this manner, the former has taken non-receipt of the certificate to mean that subsidy advance given to latter was not passed on to the farmers and should, therefore, be returned. This is something dangerous!

Apart from the huge loss of money that has the potential of turning the manufacturer sick, this is also tantamount to declaring him a fraudster. This amounts to punishing him for an alleged act that he has not committed. While the real culprit is the State, the manufacturer gets a bad name and receives the punishment!

The subsidy amount payable to urea manufacturers being more than double the subsidy on DAP/complexes, the implications of switching over to a system of payment on sale would be much more serious.

The Government should not only refrain from adopting it for urea manufacturers but also consider reverting to payment on dispatch for DAP/complex units.

There is no point in sticking to a principle if it is unworkable. And, yet, if it is felt that subsidy cannot be paid on dispatch in a free market scenario, the Government should not route subsidy through manufacturers but, instead, make payments directly to farmers.

This way, it could avoid the embarrassment of compromising on the principle and also save manufacturers from a nightmare.

Here, it is important to note that, initially, the Government intended implementation of the concession scheme for phosphate fertilisers only in this manner. In retrospect, it would appear