Who benefits from the surging fertiliser subsidy?

Fertiliser subsidy in India is justified on the grounds that the developed countries also give subsidies. But there is a fundamental difference. While the latter give subsidy as support to the farmers, in India, subsidy payments are made to the manufacturers. Subsidy given to cover inefficiency of a producer or shore up the profit of an input supplier cannot pass muster under the WTO regime, says **Uttam Gupta**.

THE Common Minimum Programme (CMP) — the guiding economic policy document of the United Progressive Alliance (UPA) Government — pledges to retain subsidies on all agricultural inputs including fertilisers.

The Union Minister for Chemicals and Fertilisers, Mr Ram Vilas Paswan, has gone a step further to say that fertilisers subsidy will not be reduced. The above position is clearly at cross-purposes with the reformist credentials of the Prime Minister, Dr Manmohan Singh.

In the Budget for 1991-92, Dr Singh proposed an increase of 40 per cent in the prices of all fertilisers from July 25,1991. Some fertilisers (ammonium chloride, ammonium sulphate and CAN) were decontrolled. Under pressure from the Opposition, the price hike was, however, restricted to 30 per cent, with exemption for small and marginal farmers.

In December, 2001, a Joint Parliamentary Committee (JPC) was set up to examine *inter alia* the working of the unit-wise retention price scheme (RPS) — in particular, the mechanism of subsidy determination and payments to the producers — and to suggest measures to reduce the outgo on fertiliser subsidy.

Based on the JPC's recommendations, in August 1992, Dr Manmohan Singh announced decontrol of all phosphate and potash fertilisers and abolished the unit-wise RPS covering phosphate fertilisers. Even as the subsidy was resurrected in a new avatar — concession support — this time, the Government decided to keep the concession uniform for all producers.

Citing several instances of plants operating at above 100 per cent capacity utilisation ("gold-plating"), the JPC had also recommended that capital-related charges (CRC) should not be paid to producers on production of over 110 per cent. The follow-up action on this came in 2000, when the declared capacities were reassessed. More action followed in 2002, when the Government revised the pricing norms based on consumption of feedstock/fuel, vintage allowance, capacity utilisation under the 7th (July 1, 1997-March 31, 2000) and the 8th pricing periods (April 1, 2000-March 31, 2003) and made recoveries from the manufacturers running into thousands of crores of rupees for the past period.

In 2000, the Expenditure Reforms Commission (ERC) proposed complete phase-out of urea subsidy in five years. The ERC recommended immediate replacement of unit-wise RPS by a group concession scheme (GCS) and total decontrol of urea in the 5th year. It also proposed targeting of subsidy only to small and marginal farmers.

Based on the ERC recommendations, the GCS was introduced from April 1, 2003. Under it, six groups were carved out on the basis of feedstock and vintage (pre-92 gas, post-92 gas, pre-92 naphtha, post-92 naphtha, fuel oil and mixed feed) for the purpose of determining the concession payable to the various units. The Government also partially removed distribution controls.

Seen in this backdrop, and given its commitment to reforms in the fertiliser sector all through, since 1991, the position taken by the present UPA Government is retrograde. What, then, is in store? Which direction will the policy take? And what will be the likely subsidy scenario?

To answer these questions, we need to take a close look at the GCS under which urea subsidy is paid to the manufacturers. The current GCS now is a distorted version of the scheme proposed by the ERC

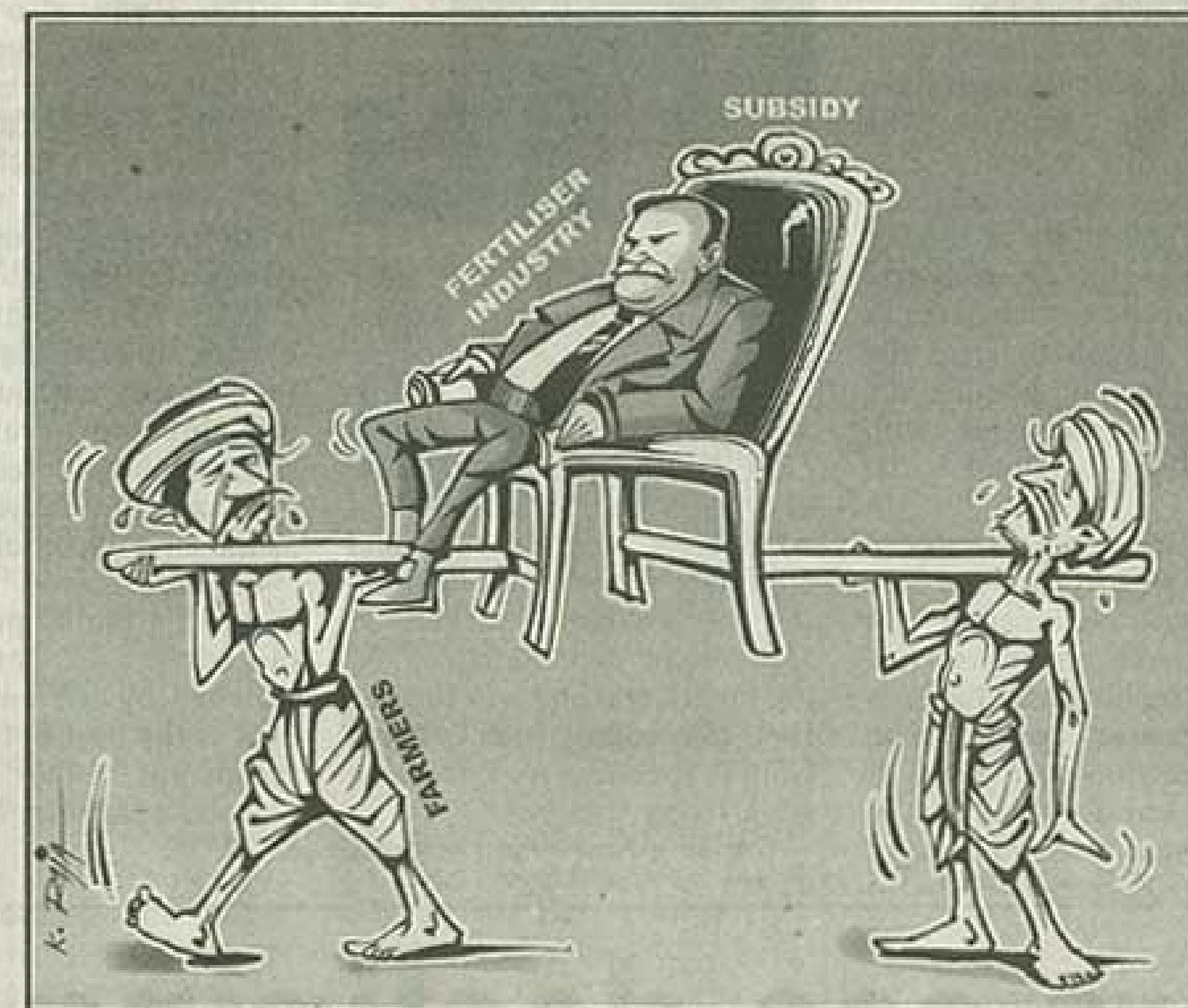
While, under the ERC all units in a group would have got a uniform price equal to the weighted average of their respective retention prices (RP), under GCS, certain units with very high RP (the so-called outliers) get a special price equal to the weighted average of the group plus 50 per cent of the difference between their RP and the weighted average.

Under ERC, escalations in cost of feedstock/fuel were computed on the implicit weighted average energy consumption of all units in the group. But under GCS, escalations are allowed on unit-specific consumption norms as applicable to the Eighth pricing period of the erstwhile RPS.

Under ERC, cost of feedstock/fuel was taken at the level of the unit buying it at least cost. For gas-based plants, the concession was computed assuming that the plant uses 100 per cent gas. In sharp contrast, under GCS, the cost of inputs and feedstock mix is allowed on actual basis.

Under ERC, fixed costs including CRC were allowed on a uniform basis. Under GCS, these charges vary within the group. These variations have been aggravated after the changes in CRC introduced from the second stage commencing from April 1, 2004.

In view of above, while the thrust of ERC was to force all producers to improve efficiency and reduce cost, the GCS does nothing of that sort. Instead, it seeks to accommodate inefficiencies of certain units. The GCS looks more like the erstwhile RPS.



Had the original Dr Manmohan Singh — the hard-core reformist — had his way, then, serious efforts would have been made to remove the deficiencies in GCS and aligning it with ERC. But, now all that seems highly unlikely. In fact, there is a strong possibility of the GCS acquiring all the unit-specific features of the erstwhile RPS.

Mr Paswan has clearly stated that all loss-making fertiliser PSUs will be revived. In this endeavour and unmindful of the impact on subsidy, the Government will be tempted to give to such units a still better price. For instance, an outlier in a group could get its much higher RP as against the weighted average plus 50 per cent of difference between its RP and the weighted average being paid now!

Under the new urea policy, as notified on January 31, 2003, the special price proposed for outliers was to be discontinued from April 1, 2004. This has not happened. And now, with the UPA Government exercising protectionism in its extreme, it may land up making the price even more attractive, as indicated above, but at the cost of the tax-payer.

The Government may also continue with the deadly concept of allowing delivered cost of inputs or feedstock mix on actual basis with greater intensity. From the subsidy angle, this has serious implications. To get an idea, let us look at the following.

During the 1990s, the prices of naphtha, fuel oil and LSHS rose steeply. The fertiliser producers offered no resistance as they too benefited from this enormously. To illustrate, if actual consumption of naphtha by a unit is less by 'X' tonnes when compared to the norm used for computing reimbursement, then, for every rupee increase in the price, it will get a bonus of Rs 'X'! According to a former Prime Minister, this bonanza added up to Rs 5,000 crore!

During this fiscal, fertiliser subsidy payments are expected to be Rs 7,000 crore higher than in 2003-04. This is largely due to steep increase in prices of feedstock/raw materials, such as naphtha, fuel oil, LSHS, phosphoric acid, ammonia etc. Such payments will only benefit fertiliser producers and their input suppliers.

Under the new dispensation, the cost-plus syndrome will not remain restricted to just the cost of inputs; it will spread to all other areas of cost viz., fixed cost viz., wages and salaries, other overheads, repairs and maintenance, CRC, marketing cost, and so on.

The Government has indicated that a number of new urea plants will be set up in various parts of the country. When, these plants come up, their production cost will be recognised on actuals. Compare this with the ERC prescription of giving them the import parity price (IMPP) of urea!

A review of the decision to partially free urea from distribution controls has been ordered. When that decision was implemented from April 1, 2003, it resulted in saving in subsidy. Now, if after the review, distribution controls come back, this will result in higher outgo on freight subsidy.

We may be heading for a scenario in which there will be padding of cost, not just in the fertiliser industry but also in all other sectors with which it has linkages. The subsidy will rise from Rs 19,000 crore (likely for 2004-05) to monumental levels.

Mr Paswan has justified fertiliser subsidy in India on the grounds that the developed countries also give subsidy. He is forgetting a fundamental difference. While the latter give subsidy as support to the farmers, in the former, fertiliser subsidy payments are made to the manufacturers.

Subsidy given to cover inefficiency of a producer or shore up his profit or profit of an input supplier cannot pass muster under the WTO regime. The issue is not whether developed countries give more subsidy than India. It is how this is given and to whom the benefit accrues. If we cannot prove that fertiliser subsidy is given to the farmers, this will have to go.

As per the roadmap released by ERC in 2000, urea should be fully decontrolled from 2005-06. The Government should stick to the ERC prescription. This is the only way to inculcate discipline among various stakeholders. Subsidy payments, if any, should be made directly to the resource-poor farmers. These payments will be WTO-compatible.

(The author is Resident Director, CropLife India, New Delhi. His views are personal.)