

Against the logic of reforms

Fertiliser manufacturers should be encouraged to produce more and at a lower cost, says Uttam Gupta

AT a recent meeting of the cabinet committee on economic affairs, convened to discuss the fertiliser retention pricing policy for the sixth pricing period, Dr Manmohan Singh is reported to have opposed full reimbursement of capital related cost for urea plants operating at 110 per cent capacity utilisation and beyond on the plea that "the decision would be against the very spirit of economic reforms programme embarked upon by the government."

The issue of whether to allow, or not, the capital related charges above the bench mark of 110 per cent to gas based units is a limited one and becomes relevant only in the context of the existing dispensation of control on urea which is covered by the retention price and subsidy scheme (RPS). Consequently, when we talk of the spirit of economic reforms programme and more specifically liberalisation, the moot question is whether the government should continue with the controls and the RPS for urea or decide to decontrol it, abolish the subsidy scheme and allow the free market forces to work. The issue of how to price production in excess of 110 per cent for any given unit is subordinate to this fundamental question and will automatically lose meaning the day urea is freed from pricing and distribution controls.

Unfortunately, on this very vital question, within the government itself there are contradictory perceptions leading to a state of a virtual indecision. Only two years back, the JPC strongly recommended continuation of controls on urea and even suggested 10 per cent reduction in its controlled selling price implying subsidy payment at an increased rate by Rs 300 per tonne. The recommendation was implemented by the government on August 25, 1992. This was not only inconsistent with the process of liberalisation started only a year earlier in July 1991, but, was in fact, a retrograde step.

An essential component of the reform exercise is that the consumers should be made to pay the market price which could either be related to the cost of domestic production and distribution or be based on the cost of sourcing the material from imports. In the case of urea, after the 10 per cent reduction the selling price was Rs 2,760 per tonne which

was only 17 per cent more than the price that the farmers were paying in 1981. At this unrealistically low level, the price was totally out of alignment with the actual cost. Had the government been sincere about pursuing reforms, an effort should have been made to at least reduce the gap between the two sets of numbers — the price that the farmers were actually paying and the cost of supplying urea. This was not done.

In fact, the contemplated increase in the selling price of urea which should have been announced in the budget for 1994-95, materialised only

in August 1992.

The price that the farmer is presently paying for urea — Rs 3,320 per tonne — is only half the cost of supplying it. In this background, "sudden decontrol" will devastate the fertiliser industry and hit everybody, specially farmers.

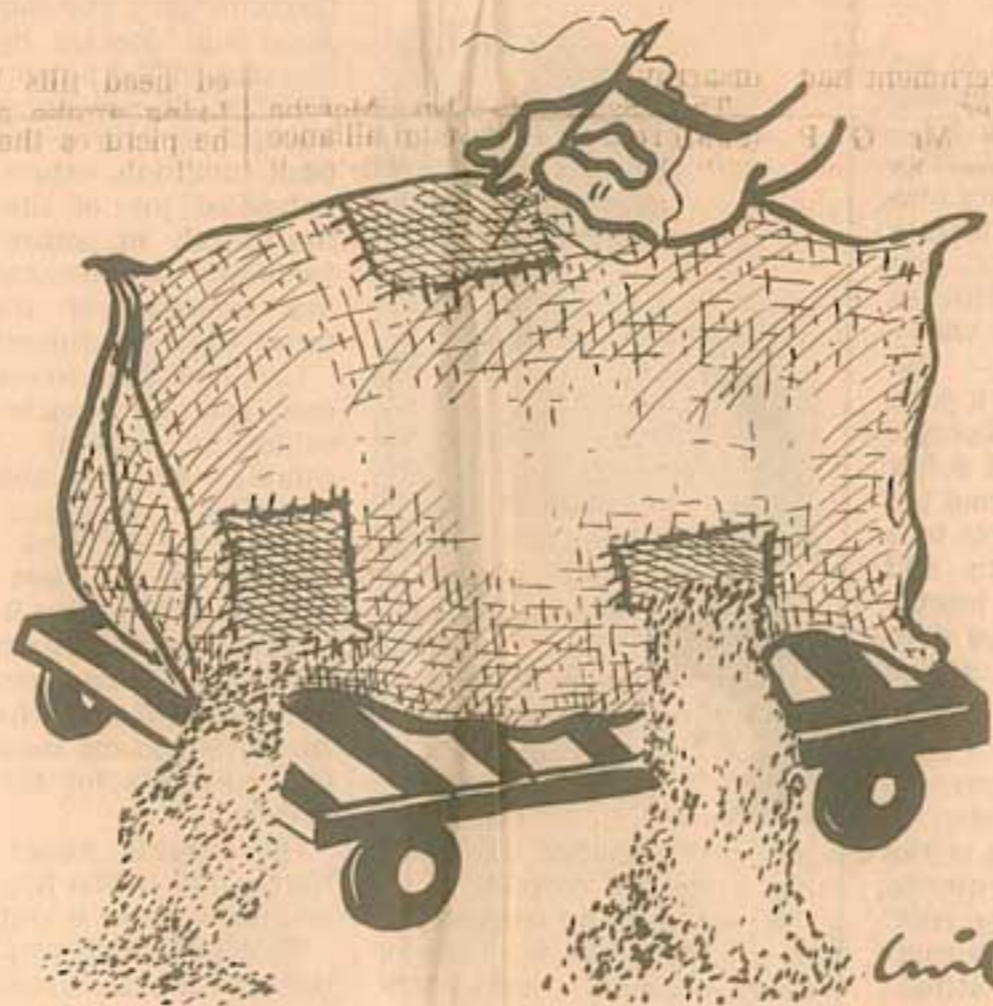
The government should spell out its intention clearly. If it wishes to decontrol urea, it should say so and put the industry on notice. But, so long as the government holds the selling price at a low level and consequently administers the RPS then it is under an obligation to give to

operate plants substantially above their installed capacity, but that does not mean that in respect of sale above a particular level, they reduce the selling price of the product to the consumers. In fertilisers, merely because the government decides to control the selling price for macro-economic reasons, the basics do not change and it would be totally unjust to reduce the producers' realisation.

Far from what Dr Manmohan Singh has observed, it is the reverse that holds. If a unit operates at a higher capacity utilisation, it facilitates increased production at a lower cost. KRIBHCO-Hazira for instance, which has operated above 110 per cent in some years in the past, gets a retention price of about Rs 3,400 per tonne. Every extra tonne produced by it should be welcome and encouraged as the cost of getting the material from alternatives is substantially higher. Any move to reduce its RP even below this level by excluding capital charges for production above 110 per cent, will not only be a serious disincentive but also constitute a retrograde step. Reforms should enable a company to produce more at a lower cost rather than discourage it from doing so.

It is also being argued that "any reimbursement beyond cent per cent capacity utilisation could be misused by urea manufacturers to claim higher subsidy by under-rating capacity." Who will do it and how? Further, which urea manufacturers does the MoF have in mind? Are we talking of the existing units? To take up the last question first, the capacity reckoned by the government for price fixation was determined when the gas-based plants were set-up which was during the second half of the 80s. These capacities were duly testified by the process licensors and equipment suppliers, thoroughly scrutinised by the government-owned financial institutions and accepted by the FICC after proper verification and authentication. How can these capacities now be changed by the government even if the manufacturer makes a request to that effect?

Even as the CCEA has deferred a decision on this critical issue, it is necessary that the finance ministry takes a reasonable view and guides the decision making process in a manner that does not put the new, efficient and highly competitive gas-based plants into trouble.



in June. Even the increase of 20 per cent fell much short of what was necessary to prepare the ground for ultimate decontrol.

A few months back, a core group on restructuring fertiliser policies was commissioned by the finance ministry to suggest alternatives to the present dispensation of control and the RPS. The views of the study group seem to suggest that the authors might be recommending ultimate decontrol of urea and abolition of the RPS. They would probably talk of a time-frame. But, what we should not forget is that any new policy cannot be implemented in isolation and the ground reality is equally important. The government ignored the latter when it decontrolled phosphatic fertilisers

the manufacturers subsidy computed as per the prescribed norms for capacity utilisation and consumption of inputs. It cannot have both — keep a control on the selling price and, yet deny producers what is legitimately due to them.

What is being suggested on the basis of the JPC formula is that on every tonne produced above 110 per cent bench mark, the retention price be reduced to the extent of the capital charges. Assuming that the former is Rs 5,000 per tonne and it includes Rs 2,000 per tonne towards the latter, what it means is that the manufacturers realisation will be restricted to Rs 3,000 per tonne. This is unexceptionable. It does not even happen in a free market. Industries