

Changing horses midstream

For saving a few crores on the subsidy account, a good fertiliser policy has been overturned, says *Uttam Gupta*

Recently, Paradeep Phosphates Limited (PPL), a government of India enterprise, was saved from being referred to the BIFR by the finance ministry agreeing to its capital restructuring plan which, amongst others, envisaged writing off its accumulated interest and changing the debt-equity ratio to 1:1. Godavari Fertilizers and Chemicals Limited (GFCL), a joint venture between the government of Andhra Pradesh and Iffco has been incurring losses for the last two years. The industry's plight is reflected in a decline in the production of P205 nutrients: from 25.6 lakh tonne in 1991-92 to 23.2 lakh tonne in 1992-93, and further down to an estimated 18 lakh tonne in 1993-94. The all-India capacity utilisation is down from 94 per cent in 1991-92 to 83 per cent in 1992-93, and further to an all-time low of 61 per cent in 1993-94.

The impairment of domestic production capacity is such that the industry has not been able to cope even with declining demand: which makes increasing food-grains production more difficult. The consumption of P205 declined from 33 lakh tonne in 1991-92 to 29 lakh tonne in 1992-93, and further to an estimated 25 lakh tonne in 1993-94. Domestic production in 1993-94 of 18 lakh tonne could meet only 72 per cent of even this reduced demand.

A plausible explanation for the downturn lies in the sudden abandonment of a "policy framework" that aided the rapid growth of the fertilizer industry in the late '70s and '80s. The government had articulated its policy through what is commonly known as the Retention Pricing (RP) and Subsidy Scheme. Its objective was twofold: to promote fertilizer consumption by keeping selling prices to farmers low and help the growth of a healthy domestic industry by allowing the manufacturers a reasonable return on their investment.

Facts for the '80s prove that these objectives have been largely accomplished. However, merely because the fertilizer subsidy also increased during this period, the policy framework drew flak. In a bid to reduce and ultimately eliminate it, the government decontrolled all phosphatic and potassic fertilizers from end-August 1992 and abolished the RP and subsidy scheme.

That led to a steep increase in the selling price of the indigenous material. DAP, for instance, went up from Rs 4,680 per tonne to Rs 7,900-8,200 per tonne. In turn, that caused a decline in the offtake of DAP of about 20 per cent during rabi 1992-93 over rabi 1991-92. The consumption of other phosphatic materials also declined substantially.

At the same time, domestic production suffered much more as imports of DAP were decanalised and allowed at "zero" customs duty, something totally inconsistent with the fundamentals of trade policy. This decision was nothing short of an invi-

tation to the US multinationals to exterminate our industries. The former indeed succeeded largely as DAP was being dumped in our market at an all-time low of US \$160 per tonne which did not even cover the cash cost of manufacturing operation in the exporting country. As a consequence,

increase from 80 lakh tonne in 1991-92 to 84 lakh tonne in 1992-93 and further to an estimated 87 lakh tonne in 1993-94. The deficit of about 14 lakh tonne in 1993-94 has been met predominantly through imports.

For several years until 1990-91, there was practically no import of urea except

the industry if the government is contemplating its decontrol, say, two years on — which seems quite likely. No effort is being made to prepare the farmers to face up to that eventuality. The fact that the proposed increase in the urea selling price was kept in abeyance shows that the government is not serious. The inevitable outcome of inaction now will be a wide gap between the reasonable cost of production and distribution on the one hand and selling prices on the other. While the former is already threatening to gallop due to increases in the administered prices of gas, naphtha, fuel oil, power etc, the latter is not being allowed to rise and was, in effect, reduced by 10 per cent in August 1992. At the present cost structure (1993-94) the weighted average reasonable cost of supplying urea from domestic industry is about Rs 5,200 per tonne, against the controlled selling price of only Rs 2,760 per tonne. The difference is being paid to the producer as subsidy. With the former likely to increase still further and no change in the latter, a sudden abolition of subsidy, say, two years from now, would mean that the farmer will have to pay an exorbitant price of well above Rs 5,000 per tonne urea: a more than 100 per cent more than the current Rs 2,760 per tonne.

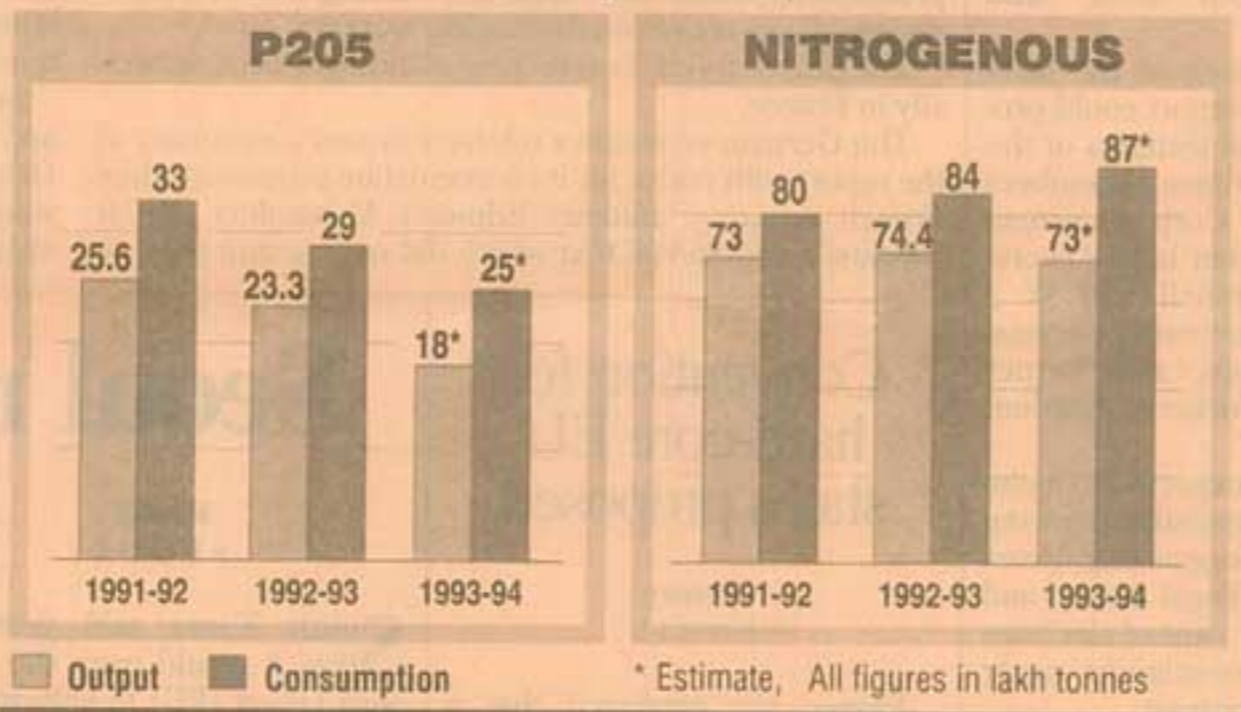
The problems in the fertilizer sector are not insurmountable. We can put fertilizer back on the normal growth trajectory provided the government seeks a purely non-political solution. In phosphatics, having decontrolled, let the government, including state governments, stop meddling. Instead, they should concentrate on educating the farmers that even with increased prices, it makes economic sense to use fertilizers. This is especially true with steep increases in the procurement prices of foodgrains since decontrol. Besides, they have to be enabled to improve the efficiency of fertilizer use, an aspect not attended to so far.

For the nitrogenous segment, an increase in urea selling price by about 30 per cent needs to be implemented immediately. The increase should be repeated next year as well. Meanwhile, the implementation of the pending JPC recommendations on feedstock prices, including gas, and various taxes and duties would help in keeping a check on cost. Starting in 1996-97, when the gap between the cost- and the selling-price would have been reduced to manageable level, the government may decide to decontrol urea and eliminate subsidy.

Having cleared the mess at the policy level, the government will have to concentrate on other vexatious issues relating to arranging adequate supplies of feedstock, particularly gas, replacement of a large number of plants that are more than 25 years old and have outlived their utility, revamping and modernisation of others and, above all, facilitating further investment in the industry for meeting the projected shortfall in production vis-a-vis the likely demand.

A SKEWED PATTERN

The graph shows the imbalance in the consumption of phosphatic and nitrogenous fertiliser. Both the output and consumption of phosphatic fertiliser have been slipping since 1991-92. In nitrogenous fertilisers on the other hand, while production has stagnated, consumption has risen steadily because of price imbalance.



almost the entire DAP industry in the country had to be closed during March-June, 1993.

Having abandoned a policy framework that worked well, no effort has been made to find an alternative though the situation deteriorated in 1993-94. When the government decontrolled phosphatic and potassic fertilizers the least it could do was ensure the working of free-market forces.

Even if the government intended to help the farmers, it could have given the ad hoc subsidy directly to manufacturers for subsidising sales to the farmer. A similar scheme was tried successfully in the late '70s, when too there was no formal pricing and distribution control and yet the intention was to help farmers by lowering selling prices. Even though the budget for 1994-95 does not continue the subsidy, the pronouncements of those who have to take decision have kept everyone guessing.

In nitrogen, which accounts for nearly 50 per cent of the fertilizer manufacturing, the picture is no different. During 1992-93, production at 74.4 lakh tonne was only marginally higher — by 1.4 lakh tonnes — over 1991-92. However, in 1993-94, it has decreased to 73 lakh tonne. In sharp contrast, the consumption of 'N' continued to

marginal quantities under bilateral arrangements with East European countries and the former Soviet Union. In 1991-92, imports were 3.91 lakh tonnes against free foreign exchange, which increased to 18 lakh tonnes in 1992-93, and to an all time high of 2.7 million tonnes in 1993-94.

For the manufacturers of nitrogenous fertilizers, the dispensation of controls has not been disturbed even as the RP and subsidy scheme remains intact. However, they too are not free from policy uncertainties. The talk of control may have temporarily died down, but it may come back any time. Even under the RPS they continue to be treated shabbily. The retention prices for the sixth pricing period, ie April 1991 to end-March 1994, which is already over, are still to be notified. This is the time when even the retention prices for the seventh pricing period commencing on April 1 this year should have been announced. Consequently, the manufacturers continue to be paid conversion and capital-related charges at old rates applicable to the fifth pricing period — April, 1988, to March 31, 1991, causing serious liquidity problems and loss of profitability.

A potentially catastrophic situation lies ahead even for the nitrogenous segment of