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# Fertiliser decontrol–a hasty plunge

**By Uttam Gupta**

IT was all done in an extraordinarily short span of just six weeks. The report of the Joint Parliamentary Committee (JPC) on Fertiliser Pricing, was submitted to the Lok Sabha Speaker on August 20, 1992. Thereafter and starting from August 25, a spate of dramatic decisions were implemented in quick succession. A far reaching decision was removal of control on all phosphatic and potassic fertilisers w.e.f. August 25. With one stroke of the pen, almost half the fertiliser industry in India which was all along operating under a controlled regime, was free to decide its activities. Did it come too soon? Was it sudden? Was the country ready for it? What are the repercussions on the industry, Indian agriculture and country's food security?

In recent years, increasing fertiliser subsdy has come under progressive atack from various quarters includng the international agencies. Subsidy is the unavoidable outcome of controls on the selling price on the one hand and higher cost of production and distribution on the other. So, if the subsidy has to be eliminated, an apparently simple solution is that controls must go. Against this backdrop, while negotiating the IMF loan under the stand-by facility last year, the Government promised complete elimination of fertiliser subsidy within three years starting from 1991-92. The Union Budget of 1991-92 gave some indication of the Government's intention when three nitrogenous fertilisers i.e. ammonium sulphate, Can and ammonium chloride were decontrolled and a subsidy ceiling on SSP, an important phosphatic fertilisers, introduced w.e.f. July 25 1991. In the Union Budget for 1992-93, the Finance Minister made an allocation of only Rs 5,000 crore for fertiliser subsidy against a likely demand of about Rs 8,300 crore. Read this in conjunction with his subsequent press statements that no more funds would be made available under this head. And, no one would have any doubt about the impending decontrol. The JPC report recommending removal of control on 'P' and 'K' fertilisers, put the SEAL on it, Under these circumstances, the decision was neither too soon nor sudden. But, what about our state of preparedness?

A quick review of the pricing situation prevailing at the time of decontrol is called for. Prior to August 25, 1992 the farmer was paying for P and K fertilisers at controlled selling prices which were completely out of alignment with the cost of production/procurement and distribution. It happened because during the decade of 80s, while the cost of various inputs used in production of fertiliser had risen considerably, fertiliser selling prices remained more or less unchanged until July 24 1991. Let us take the example of DAP an important phosphatic fertiliser containing 18 per cent 'N' and 46 per cent 'P205'. Before August 25, its selling price was Rs 4,680 per tonne achieved after the 30 per cent hike w.e.f. August 14, 1991. Against this, on the basis of retention prices notified by the Government w.e.f. October/November 1991, freight and distribution margin, the reasonable cost of production and distribution on a weighted average basis for the industry was about Rs. 9,400 per tonne. Thus, the gap was as high as 100 per cent.

Precise data with regard to the present cost structure is not available. However, we can have some idea by looking at the change in rupee cost of phos acid and ammonia, the two principal imported intermediates in production of DAP by majority of the units. At US $ 411 per tonne and US $ 158 per tonne being the C&F landed cost of phos acid and ammonia, respectively, in October/November 1991 and considering 13 per cent custom duty on the former, their contribution in cost of one tone DAP works out to about Rs 6,600 per tonne. The prices relevant to production during the first half of 1992-93 are US $ 365 per tonne phos acid and $ 118 per tonne ammonia. Despite these substantially lower prices, their rupee cost in one tonne DAP is higher at about Rs 6,800 per tonne. This was primarily due to the partial convertibility of the rupee though the Union Budget for 1992-93 under which phos acid and ammonia were imported w.e.f. April, 1992 at the higher market rate of exchange. On this basis and assuming no change in costs other than phos acid and ammonia i.e. Rs 2,800 (9,400 - 6,600), the reasonable cost of production and distribution of indigenous DAP available in the market would be about Rs 9,600 per tonne.

Clearly, the situation was disappointing from the view point of both the farmers as well as the industry. Even the JPC which recommended such a drastic step was not oblivious of this. That it was not, should be clear from the spate of recommendations it has made to reduce the cost push. Amongst others, these include elimination of the customs duty on phos acid imports and allowing import of all raw materials and intermediates at the official rate of exchange. For a unit based on imported phos acid and ammonia, these measures would lower the cost by about Rs 1,700 per tonne. Others having captive phos acid and therefore, using imported rock phosphate and sulphur get the benefit only the lower official rate and not customs duty as these raw materials did not attract this duty earlier. Consequently, reduction in their case is much less. Even after downward adjustment for this, the reasonable cost of production and distribution would still be about Rs 7,900 per tonne (9,600-1,700). It must however, be emphasised that this would be applicable only to 'fresh' production and not the material available for use by the farmers. To the farmer, the selling prices will be still higher to the extent of the local taxes. In Uttar Pradesh for instance, sales tax at 6.25 per cent works out to about Rs 450 per tonne. It can thus be said conclusively that we have not at all prepared ourselves to face the consequences of decontrol.

Let us now assess the repercussions. That these would be adverse was not entirely unexpected. In a fundamental sense, these originate from the farmer's expectation of getting the material at a rice which is not much higher than he was paying earlier on the one hand and the inability of the industry to supply it below a certain critical level on the other. Both have had their own share of compulsions. Take the case of the farmer. Only about a year ago i.e. prior to July 25, 1991, he was paying for DAP at the rate of Rs 3,600 per tonne. Currently, even at the bare minimum i.e. about Rs 8,000 per tonne, he is expected to pay a whopping 125 per cent more. Including local taxes being levied in many states, this would be even more. Inevitably, there is bound to be demand resistance and in this situation, even the least cost producer would face a tough task in selling the material. This is where the problems of the industry generally can be sourced. For the newly commissioned high cost units and those having their own captive phos acid facility, it is indeed a struggle for survival.

On its part, the industry has been trying to adjust to the unfolding situation. It secured further reduction in prices of imported phos acid and ammonia by US $ 24 and US $ 3 per tonne, respectively, on quantities to be supplied during October-December 1992. Coming on top of the earlier reduction of US $ 15 on phos acid and $ 6 per tonne ammonia for the July-December 1992 supplies when compared to the prices finalised by MMTC for April-June quarter, this was unprecedented. Besides, in finalising selling prices, more than its viability concern, it has kept in mind the need to keep prices to farmers at resonable levels. In the case of DAP for instance, at Rs 7,900-8,200 per tonne excluding local taxes these even ignore the much higher cost material already in position as also various cost escalations during the last 12 months or so. While these efforts have definitely resulted in significant reduction in the cost, short of any magic formula, there is nothing that could match even the reasonable expectations of the farmers in the present decontrolled situation.

In a desperate bid to retrieve the situation and in seeking to achieve the near impossible, the Government intervened though a series of ad hoc measures. It decanalised DAP import permitting its import without licence by all persons, introduced on ad hoc subsidy and even stipulated a totally unrealistic selling price of Rs 6,500 per tonne DAP. By creating confusion and uncertainty in the market, the decisions with regard to subsidy and a cap on the selling price have already done their part of the damage as sales even at the peak of the Rabi 1992-93 season came to a virtual standstill. From a long-term point of view, however, these are inconsequential as the proposed subsidy covered only a brief period of three months i.e. up to December 31, 1992. This is not to disregard the psychological hangover of artifically forced low prices which may persist for some time. As regards decanalisation, this hangs like a Damocles sword and poses a series threat not only to the survival of domestic industry, but also, to Indian agriculture.

The problem here is that while we tend to think that the cost of DAP import represents its true opportunity cost, this is only a 'myth'. Consider for instance, prevailing C&F landed cost of imported DAP at US $ 180 per tonne. On the face of it, it may carry massive appeal as at this level the corresponding farmgate cost after adding handling and distribution cost, works out to about Rs 7,000 per tonne; a significant Rs 1,000 per tonne lower than the price at which indigenous DAP is available. But, wait a minute, US $ 180, in respect of material coming from the US translates to f.o.b. realisation of about US $ 140 to the American producers. At this level, they are incurring losses. And yet, they cannot afford to raise prices because of overall weak global demand for DAP on the one hand and increasing pressure of supplies particularly from CIS (former Soviet Union Republics). But, this scenario will not last long particularly when China the biggest importer of DAP in the world market, will re-enter after the present lull. Only two years back, i.e. in 1990, we have paid US $ 230 per tonne for DAP.

Can we therefore afford to expose our industry to the danger of flooding the imported DAP in the market at present unrealistically low price? To say that the industry could restart production later when it becomes cost effective vis-a-vis imports is a self-defeating argument. Switching on and off the wheels of the industry in tune with the highly volatile and fluctuating international market is nothing short of being suicidal. From the farmer's viewpoint also, the supply of a sensitive commodity like fertilisers cannot be left to the decisions of the traders who, by definition, do not have a permanent stake in ensuring availability of the material in required quantities.

In retrospect, we have an unfortunate post decontrol situation wherein both the farmers and the industry are at a tremendous loss.

Continued on page 11

# Fertiliser decontrol –a hasty plunge

Continued from page 6

Even in terms of tackling the high cost syndrome bedevilling the fertiliser sector, it has been the famous case of one step forward and two steps backward. W.e.f. September 16, 1992 the prices of naphtha, fuel oil and LSHS, were steeply raised by 36 per cent, 54 per cent and 54 per cent, respectively. More recently, under a directive from the Ministry of Petroleum & Natural Gas, the oil companies have withdrawn retrospectively w.e.f. September 9, 1992, the concessional price for use in fertiliser manufacturers other than feedstock. This will tantamount to raising prices of naphtha, fuel oil and LSHS to fertiliser units by more than 100 per cent. In turn, this has pushed up the production cost of DAP and other complex phosphatic plants having captive ammonia based on these feedstock. The decision is contrary to the JPC recommendation which wanted freezing the prices of all feedstock in fertiliser manufacture other than gas in respect of which it has recommended 35 per cent lowering of the price. To cap it all, the contemplated full convertibility of the Rupee as and when it comes, will further escalate the cost of production steeply by as much as Rs 1,000 per tonne for DAP plants using imported phos acid and ammonia. For others based on imported rock phosphate and sulphur also, the effect will be substantial. Consequential results in terms of what the farmer can afford on the one hand and prices at which the industry would be viable from next year onwards could be mind boggling.

Could we have prevented this? Definitely yes. But, that would have called for a clear cut recognition that immediate decontrol would mean a sudden and steep increase in the burden on the farmer. On this basis, without changing the present system of controls, an increase of only 20 per cent in the selling price of all fertilisers in the beginning of the year itself would have given a saving of about Rs 1,800 crore in subsidy. Incidentally, this is all that has been achieved for the current year through various Government's decisions w.e.f. August 25, 1992 including the decontrol of P & K fertilisers. Removal of customs duty on phos acid and allowing raw material and intermediate import at the official rate would have saved another Rs 950 crore or so. Along with reduction in the Railway freight, the total saving would have been enough to keep the fertiliser subsidy requirement within the budgeted level of Rs 5,000 crore. In turn, even the industry would have been saved of the financial crisis as, in recent years, it has been "generically" related to a serious imbalance in fertiliser subsidy budget.

As for total elimination of subsidy at one go we cannot afford to take an 'orthodox' view on this. Unfortunately, we are being forced in to it by those who themselves maintain agricultural subsidies at very high levels. But for these, they apprehend displeasing their farm sector. That is why even the talks at the Uruguay Round have been deadlocked. For a developing country like India, the risk is 'real' and much greater particularly when we are far from prepared. That the impending danger is not unreal, is clearly borne out by the experience of countries which have made this mistake. According to International Fertilizer Industry Association (IFA), between 1988 and 1991, N, P and K use declined in Eastern Europe and the former Soviet Union by 40 per cent and 48 per cent, respectively. In their view, this was primarily the result of the reduction or elimination of fertiliser subsidy in this region and the chaos associated with the transition from centrally planned to market economies. Specifically, reforms in Poland more than doubled the fertiliser-grain price ratio over the past three years. As a result, fertiliser application rates dropped by 1/3rd from more than 180 kg/ha in 1988 to less than 120 kg/ha in 1991. In turn, the yields could fall to 80 per cent of achievable levels and would fail to safeguard nation's food self-sufficiency.

However, this is only a postmortem now. Having brought about decontrol, we have to decide as to how best we can deal with the transition and mitigate the adverse consequences. Of utmost importance, is the need to carry the process of controlling the cost push to its logical climax. In this context, all the JPC recommendations need to be implemented in toto immediately.

Specifically, the recent hike in the naphtha, fuel oil and LSHS prices should be rolled back and the 35 per cent reduction in the gas price implemented without further loss of time. Various taxes and duties being collected by the state governments should be eliminated immediately. It is totally illogical to voice concern about high prices to the farmers and yet boost them artificially by collecting sales tax. Railway freight reduction should cover all fertiliser raw materials and finished products. Most importantly, we need to be ready with adequate compensatory measures to deal with the consequences of rupee being made fully convertible. Finally, even though decanalisation of DAP is a fate accomplice, it is necessary to ensure that only the industry is authorised to import the material as this would not only help in regulating the supplies, but also, give them necessary flexibility to smoothen the prices to the farmers by pooling cost of imported DAP and indigenous production. Adoption of this package may not provide immediate big relief to the farmers from the onslaught of sudden decontrol. Nevertheless, it may help in facilitating a smooth transition.