

Fertiliser subsidy—a misnomer: I

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FERTILISER subsidy, to a certain extent, is a necessary price the country has to pay for self-sufficiency in foodgrains. This apart, the burgeoning subsidy on fertilisers is not as frightening as it would seem.

thereof is called for here.

Control on selling price

The most significant feature of the price situation in fertilisers is that, unlike many other commodities, fertiliser prices to farmers are controlled by the Government under the Fertiliser Control Order (FCO) whereby a uniform price is fixed throughout the country subject only to local taxes/levies enforceable by the state governments and Union territories concerned. This price is pegged at a reasonably low level to put a costly input as fertiliser within affordable limits of the farmers, majority of whom are in the small and marginal category.

The ultimate objective is increase fertiliser use consistent with the overriding need to increase agricultural production. As a logical corollary, the consumer price has no semblance with the cost of production in sharp contrast even to other basic commodities subject partially or fully to administered price control, like steel, cement, sugar, etc., wherein the prices chargeable to consumers are essentially based on allowing reasonable cost of production to manufacturers.

It is important to note that controls exist not merely on the consumer price of fertilisers: they cover a wider spectrum ranging from the cost of inputs including feedstock, utilities, intermediates to transportation, marketing and distribution which constitute important elements in determining the cost of making fertiliser available to the farmers. The prices of naphtha, fuel oil, natural gas, coal, power tariffs, railway freight, etc., are all fixed by the Government and quasi-government bodies including ONGC, IOC, CIL, SEBs and the Railways. The prices of rock phosphate, sulphur, imported phosphoric acid important inputs and intermediates in the phosphatic fertiliser industry, too—are administratively controlled. Even the distribution margins, i.e., the remuneration for distributing the material, are notified by the Government from time to time.

Yawning gap

Against this background, it is very unusual that, whereas on the one hand the prices paid by the farmer have remained unchanged for years together (for instance, the prices prevailing now correspond to the levels obtaining way back in July 1981 after having been reduced by 7.5 per cent in July 1983), the cost of various inputs and utilities besides freight on transport, etc., have increased by leaps and bounds during the same period. For instance, the landed price of naphtha, an important feedstock accounting for 40 per cent of the fertilisers capacity in the country, has increased by over 200 per cent since 1978-79.

The price of gas being charged to the newly commissioned plants such as Thal of RCF, etc., is nearly six times the price being charged from Iffco or GSFC in 1979 and 15 times the price paid by Iffco earlier. The tariffs on power and railway freight have increased by over 150 and 300 per cent, respectively, in the last few years. Likewise, the prices of imported sulphur, rock phosphate and imported phosphoric acid, etc., have also increased manifold during the last few years.

Incidentally, this also happened to be the period when fertiliser capacity in India increased enormously consequent upon commissioning of new plants including the giant ammonia/urea complexes at Thal and Hazira with a total capacity of around 2.9 million tonnes of urea going on stream in March 1985 and November

1985, respectively. Could the existing as well as additional capacities be operationally viable even in the face of a yawning gap between price paid by the farmer on the one hand, and swelling cost of production on the other?

Retention price

In the normal course, it is inconceivable to expect such a situation to continue unless there is appropriate Government intervention to see to it that the fertiliser units survive and even grow in an efficient manner. In all legitimacy therefore, such an intervention should take the form of allowing a reasonable cost of production to the producer this in the face of low realisation resulting from fixation of the sales price at an extremely low level unrelated to the cost which the producer has to pay for inputs and utilities, besides higher capital-related costs, particularly for newly commissioned units.

The retention price scheme (RPS) was implemented in November 1977 for nitrogenous fertilisers and February 1979 for complex/phosphatic fertilisers consequent to the recommendations of the Marathe Committee which examined the related issues in ample details. The scheme essentially seeks to provide a suitable way out of the dilemma posed by a low consumer price, on the one hand, and higher unit cost of making fertilisers available to the farmer, on the other, without at the same time adversely affecting the growth of the industry.

Under RPS, a fair price (retention price) is assured to a given unit which is expected to cover its cost of production at given efficiency norms with regard to capacity utilisation and consumption of various inputs and utilities besides including a reasonable margin of profit, currently at 12 per cent post-tax return on net worth (equity + free reserves) which is also subject to achievement of the prescribed efficiency norms.

In the case of an ammonia/urea complex for instance, the fixed costs including the capital-related cost, are computed at 80 per cent capacity utilisation of the ammonia plant. Consequently, a unit operating below the prescribed norm will not be able to recover its fixed cost and would even suffer on the variable cost in view of more frequent shutdowns and start-ups entailing higher consumption of variable inputs than allowed for purposes of price computation.

In other words, the inefficiency of the concerned unit will be penalised under the pricing scheme in the form of lower profitability or even losses. The efficient unit, on the other hand, operating above the prescribed norm of 80 per cent capacity utilisation would save on both fixed and the variable cost thereby adding to its profitability. That is, RPS provides suitable signals incentives for the units to do better and discourages units from becoming inefficient.

The significantly positive impact on the efficiency in operation consequent upon introduction of RPS can be seen from the consistent improvement in overall performance of the fertiliser industry during last one decade or so. The overall capacity utilisation rate in respect of nitrogenous fertilisers increased from 62 per cent in 1975-76 to 72 per cent in 1984-85 and is expected to be a record 80 per cent during the current year, i.e., 1986-87.

In respect of phosphatic fertilisers, too, there have been phenomenal gains from a low level of 45 per cent in 1975-76 to 87 per cent in 1986-87. It is significant to note that these national averages mask exceedingly low capacity utilisation rates for a number of plants in the public sector

which have not been able to come up to specified standards predominantly because of certain inherent design and equipment defects, on the one hand, and power interruptions on the other, which tend to further aggravate equipment problems besides reducing substantially the output levels.

Units in the co-operative and private/joint sectors, besides some of the public sector undertakings including RCF, MFL and NFL, etc., have by the large done exceedingly well with the capacity utilisation factor anywhere in the range of 90-100 per cent (In certain cases, it has exceeded 100 per cent during some periods, because of extraordinary levels of operational efficiency).

Quite apart from the general improvement, increased efficiency has covered a much wider spectrum of the fertiliser industry. This is confirmed by near doubling of the number of units, i.e., from eight to 16 reporting above 80 per cent capacity utilisation rate during 1975-76 to 1985-86.

In view of the above, the conventional arguments that subsidies are designed to protect inefficient industries and that inefficiencies in turn lead to more subsidies is factually not correct insofar as the fertiliser industry is concerned. Obviously, it would be preposterous to call a unit inefficient purely on grounds of having received subsidy, despite the fact that it is operating at near 100 per cent capacity utilisation rates and that, even in terms of consumption of variable inputs—particularly energy, which is a major element in fertiliser cost—the actuals are comparable to world standards. (The energy consumption factor of ammonia/urea complexes for some of the newly commissioned units, for instance, has been eight-nine pcal per tonne of ammonia).

The fact that, despite the observed efficiencies and improvements thereof, subsidies exist indicates the need for a careful scrutiny of the basic concept in the context of fertilisers.

RSP assures a fair price to the producer in view of the consumer price having been fixed at a low level to protect the interest of the farming community. The difference between the retention price and the net realisation (consumer price-distribution margin) is reimbursed to the unit in case the former exceeds the latter. In case of the latter exceeding the former, the unit concerned is required to pay back the excess to the fertiliser price/subsidy account maintained and run by the fertiliser industry co-ordination committee (FICC) under the Department of Fertiliser, Ministry of Agriculture.

In view of the factors brought out above, the reasonable cost of production at given efficiency norms is higher than the net realisation for the entire cross-section of the fertiliser industry, barring three units at present, whose costs of production tend to be low predominately because of the low price of natural gas charged to them under long-term supply arrangements with ONGC. It is likely that, following the recent fixation of the price for onshore gas at a level of Rs 1,400/- per 1,000 cu.m. which, together with various levies would work out to nearly 400 per cent more than the price currently being charged to these units, even this marginal category contributing to the national kitty under RPS would disappear.

Consequently, all the fertiliser units irrespective of their levels of efficiency would be dependent on subsidy for their survival and continued growth. This calls for a dispassionate analysis of the factors contributing to the increase in the fertiliser subsidy.

(To be concluded)

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THE Centre's finances have been in a bad shape for quite some time now, with the available resources lagging far behind the ever-increasing expenditure consistent with the growth targets laid down by the Government. Nothing can demonstrate this better than a whopping deficit of over Rs 8,285 crores for the current year more than twice the level initially provided for in the Budget for 1986-87.

The Budget for 1987-88 has consciously pegged the budgetary deficit for the year at Rs 5,688 crores, which seems to reflect the discomfiture of the Government over the unprecedented increases during the past, on the one hand, and on the other is seeming determination to do something very drastic to avert recurrence of similar situations. Towards this end, a Cabinet committee has also been constituted to monitor the expenditure by various administrative ministries and central organisations to ensure that actuals are contained well within allocated amounts.

It goes without saying that the pendulum has swung heavily towards the non-Plan expenditure, which takes more than two-third, of the total earnings of the Government as per projections for 1987-88 contained in the Union Budget. Obviously, interest, defence and subsidies constitute an overwhelming share of the total non-Plan expenditure. While the compulsions to spend heavily on defence in the context of the worsening security environment leave hardly any scope for possible reduction on this account, subsidies have undoubtedly been an area of serious concern wherein the Government has reiterated time and again, the dire need for bringing about substantial savings.

Notwithstanding this, subsidies continue to move on a rising trajectory. During 1987-88, subsidies on food, fertilisers and export promotion put together have been projected at Rs 4,780 crores representing over 12 per cent of the total non-plan expenditure. This calls for a detailed examination of the factors contributing to rising subsidies with a view to ascertaining chances of success of a possible move to keep the subsidies in check. It is proposed to analyse the case of fertilisers in this paper, is one of the significant elements of expenditure in the non-plan category.

Subsidy Syndrome

Customarily, subsidy tends to connote some sort of a 'budgetary support' given to an industry to enable it to survive despite its weaknesses manifesting in the form of inefficiencies or higher costs. This support is normally given for a certain period of time, to enable the industry come up on its own, become efficient and competitive and thereby obviate the need for further continuation of subsidy any more. If, however, the industry getting subsidy support becomes perpetually dependent on the Government for its survival, subsidy becomes counter-productive, implying wastage of precious national resources.

Under such circumstances, subsidy needs to be discouraged as this would only lead to proliferation of inefficient units if allowed to continue. It may be interesting to see how far this subsidy syndrome fits in with fertiliser industry wherein the subsidy quantum on indigenous fertilisers has increased manifold in recent years from Rs 170 crores in 1980-81 to Rs 1,700 crores estimated for 1986-87.

(The subsidy on imported fertiliser is not considered as the same is, by and large, exogenous to the Indian Industry, determined as it is by international price and availability situation on the one hand, and the price charged to the farmers which in turn, is a conscious policy variable fixed by the Government).

A brief overview of the fertiliser price situation to enable a objective appreciation of subsidy ramifications