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Re. partial convertibility deals a blow to fert. industry

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IT all started with a sudden and dramatic announcement in the Union Budget regarding partial convertibility of the Rupee. The day following the presentation of the Budget, Finance Ministry issued a notification indicating the items on the negative list. A closer scrutiny of this list brought out that rock phosphate and sulphur, the two basic raw materials in production of phosphatic fertilisers, were "missing". The precise implications was that henceforth, these items stood decanalised and user industries were free to import them directly. A spontaneous reaction may well be one of exuberance as the industry was now being freed from the bondage of the MMTC, the canalising agency for import of these principal raw materials hitherto. In fact, much before the announcement some of the manufacturers had even maintained that given the opportunity, they could do a better job. But, a crucial factor the ramifications of which have not been so well comprehended is that the foreign exchange for these raw materials has to be bought at the market rate w.e.f. 1st March, 1992.

Before we look at that, let us consider what the emerging dispensation had in store for phosphoric acid and ammonia, the two vital intermediates that also go in the manufacture of phosphatic fertilisers and have to be largely imported to support more than 50 per cent of domestic P_2O_5 capacity. These items found mention in the negative list and consequently, continued to be canalised through the MMTC which has been doing this job for only two years now. Concomitantly, there was a fairly legitimate expectation that import of these intermediates by the MMTC should be possible at the official rate of exchange. But, the RBI had a different perception altogether. Because the Finance Minister's speech only talked of fertilisers to be covered by the 40 per cent category, how could imports of intermediates i.e. phos acid and ammonia, qualify for imports at the official rate? The RBI's job was made easier with the announcement of the new import-export policy w.e.f. 1st April, 1992, which dropped even phosphoric acid and ammonia from the negative list. Since these items too now stand de-canalised, the industry will now have to arrange foreign exchange at the market rate to finance their procurement. Ironically, even in respect of shipments received prior to 1.3.1992 and for which payments became due afterwards because these supplies were under 180 days credit facility under Govt. directive, foreign exchange was not made available at the official rate.

Let us now evaluate what the partial convertibility regime implies in terms of the resultant cost structure for the industry. First, consider a plant based on imported rock and sulphur; their prevailing C&F prices are US $68 per tonne and US 86 per tonne respectively. On an average 1.5 tonne of rock phosphate and 0.5 tonne of sulphur is needed to produce a tonne of DAP. In terms of US $, thus, the corresponding expenditures are 102 (68 x 1.5) on rock phosphate and 43 (86 x 0.5) on sulphur. Now assuming that on an average Rs. 6 to a dollar is spent extra on buying the latter from the market, the additional rupee cost of producing a tonne of DAP will be Rs. 870 ((102 + 43) x 6).

For a plant based on importd phos acid and ammonia, the impact is much more as these are value added products. On the basis of current C&F price i.e. US $370 per tonne for phos acid and US $115 per tonne for ammonia and considering that 0.49 tonne and 0.221 tonne of these respectively are needed to produce a tonne of DAP, the expenditure in terms of US $ works out to 207 (370 x 0.49 + 115 x 0.221). Taking the differential of Rs. 6 to a dollar between the market and the official rate of exchange, the impact on cost of producing a tonne of DAP, due to changeover in the exchange regime will be Rs. 1242 (207 x 6). In addition, there is customs duty on phos acid imports i.e. 12 per tonne on quantities coming from Morocco and Tunisia and 15 per cent from other sources. Considering that the former's share is 70 per cent, the effective rate on total quantities comes to about 13 per cent (12 x 0.7 + 15 x 0.3). And, since this is collected on the value computed at the market rate of exchange, the Rs. 6 differential in exchange rate will add to the cost by another Rs. 141 or so (48 x 0.49 x 6, $ 48 being the element of duty).

It may be argued that these cost pushes could be offset by lowering of the C&F price in US dollars. Indeed, that is the essence of liberalizing imports. Let us not at the moment get into the question whether or not MMTC was getting the most competitive prices or for that matter the user industries have the capability to secure terms even better than MMTC. Today, these questions are only hypothetical and can best be evaluated only after we gain some experience. Could we assess the order of magnitude of reduction that would be necessary to ensure that cost-wise the users remain unaffected?

Thus, the C&F price in US dollars per tonne will have to be lower by 13 for rock phosphate, 16 for sulphur, 70 for phos acid and 22 in the case of ammonia. Reductions of this order seem highly improbable particularly when we consider that whereas on the one hand, the international market for supply of these items is highly oligopolistic, and on the other, the country would no longer have the advantage of bulk purchase. although, the industy may have to contemplate "consortium" arrangements to ensure that the suppliers don't exploit the situation and some of the user industries may even succeed in negotiating a few dollars reduction on the basis of their somewhat better preparedness in terms of negotiating skills, effective intelligence, organizational capabilities and response time, the scope for countenancing the negative effect of the higher market value for dollar just does not exist.

While we have worked out the cost implications on the basis of the prevailing market rate of exchange at Rs. 31.5/-, there are reasons to believe that this rate will not only sustain but may even increase during the course of the year. In this context, the NCAER has recently estimated that the demand for foreign exchange in the open market will exceed the supply by about US $4 billion and this too under the most optimistic assumption of exports during 1992-93 growing at the rate of 12 per cent. Further, since these calculations were done before the announcement of the new export-import policy decanalising many more items including phos acid and ammonia, their consequential impact will further aggravate the gap. While we may be told that in a flexible exchange regime, the Rupee can move both upwards as well as downwards, the experience only points towards irreversible tendency of downward movement only. Let us recall the events of the last one year or so. When the first bout of devaluation came in July 1991, we were told that this was the bottomline and that the Rupee will not be allowed to slide further. But, within a matter of few days, it was further devalued. The first week of July saw the US dollar rising by over Rs. 5/-. Barely 8 months thereafter, it has jumped by another Rs. 6/-. Currently, Rs. 31.5 are needed to buy a US dollar. The Finance Minister may dismiss this as a natural outcome of the new regime of partial convertibility. But, the ground reality is that this is another devaluation of the Rupee thru the backdoor. Even the Government tacitly admits this by seeking to collect customs/stamps duty on value of imports evaluated at the market rate of exchange.

Even as the policy makers may get away by submerging the harsh realities in rhetorics which is what makes an impact on the ignorant populace, the industries have no option but to face the serious consequences. To gauge what it means, let us consider the case of phos acid. During the greater part of 1991, its C&F price hovered around US $ 400 per tonne. Inclusive of customs duty, this is $452. And yet, because of the July, 1991 devaluation its Rupee cost increased by Rs. 2,260/- (452 x 5). Meanwhile, the C&F price in US dollar has gone down to 370. With 13 per cent customs duty this works out to US $ 418. And, despite this, because of the requirement to buy $ at market rate under partial convertibility regime, the Rupee cost of a tonne of phos acid now is 13,167, which is Rs. 1,641 per tonne more than it was immediately after the July, 1991 devaluation i.e., 11,526 (452 x 25.5). At the prevailing price of $ 418 (inclusive of customs duty), the cost push of buying foreign exchange at the market rate alone is Rs. 2,508/- per tonne (418 x 6). Indeed, but for the lowering of C&F price in US $, the total increase in Rupee cost on account of two devaluations one de jure and the other de facto, would have been a whopping, Rs 4,972 per tonne (452 x 11). Even after considering the reduction in $ price, this works out to Rs. 3,901 per tonne phos acid (418 x 31.5 – 452 x 20.5).

In fertilisers, there is a further complication. Because the selling price is controlled at low level unrelated to the cost for overall food security reasons, such cost push will only mean increase in subsidy payment. In this context, the July devaluation of the Rupee raised subsidy during 1991-92 by about Rs. 900 crore. Its continued impact for 1992-93 means Rs. 1300 crore for this year. Add to this another Rs. 673 crore or so, due to the defacto devaluation of this year through the partial convertibility of the Rupee. The additional subsidy burden on account of exchange rate adjustment in a span of less than one year is thus about Rs. 2,000 crore during 1992-93. Compare this with a meagre saving of less than Rs. 100 crore due to decontrol of the so-called low analysis fertilisers i.e. Ammonium Sulphate, CAN and Ammonium Chloride and a subsidy ceiling on SSP in July 1991 which has jeopardised the viability of these industries. Is this the kind of price that the country must pay for a move towards convertibility of the Rupee?

Subsidies are treated with contempt by the reformists. Fertiliser subsidy is no exception. Besides drawing flak from various quarters, it has become the sole reason responsible for the present financial ill-health of the industry. During 1991-92, the industry suffered heavily due to non-payment of subsidy dues in time because the budgetary allocation was far from being adequate. This year, the situation will further aggravate. As against a likely requirement of about Rs. 8000 crore (including Rs. 1,400 crore being the throw forward from 1991-92), the allocation is only Rs. 5,000 crore. While the industry may still be made a convenient scapegoat for the galloping subsidy, the Government can't escape the responsibility as much of the increase in subsidy has come about because of increase in the administered prices of basic inputs, railway freight, devaluation, customs duties etc.

In his Budget speech, the Finance Minister stated that "the new system is designed to provide a powerful stimulus to exports as well as efficient import substitution". Here is a case of an industry which has been working at efficiency levels par excellence and comparable to the best in the world. In fact, the all India average capacity utilisation rate during the first 10 months of 1991-92 was 87 per cent in N sector and 96 per cent in P_2O_5 sector. Excluding some of the plants in the public sector which are chronically sick because of design and equipment defects apart from labour problems, the performance rate in 'N' is over 100 per cent. But, unfortunately, by various actions including the devaluation of the Rupee pushing up the cost of production and consequently subsidy and then, a series of counter actions, manifesting as adverse changes in pricing norms and delayed payment of subsidy dues and escalation claims we have come to the verge of making an otherwise efficient industry sick.

There is another angle to the story of partial convertibility. It may be argued that the higher cost of imported inputs/intermediates could be offset by better realisation on 60 per cent of the export earnings at the market rate. Here again, we must not forget that because of the strategic importance of fertilisers and the shortfall in domestic production vis-a-vis the demand, they cannot be exported. In fact, at present, excepting ACL, AS and CAN which have been decontrolled, there is a ban on export of major fertilisers such as DAP, urea and SSP etc. In view of this, there is nothing positive that the present partial convertibility regime offers to fertilisers manufacturers.

Critics of change are some times heckled for not accepting the adjustment process in its stride. There could be orthodox views on the subject which can't be denied. However, in this case we need to take a more pragmatic view transcending ideologies favouring various extremes.

Protagonists of free market might still say that we are not allowing the adjustment process to work fully. Faced with higher cost or for that matter reduced availability, why should the demand for phosphatic fertilisers not be reduced. After all, this is how the changes in price should enable a new equilibrium between demand and supply. Taking the point to its logical climax would mean that the Indian soils must learn to live with reduced availability of phosphate nutrient. Perhaps, on the basis of this philosophy in the not too distant future, even the poor masses of this country can be told that they should learn to live with inadequate food because they cannot afford the consequential higher cost.

A question that arises then is what the Government should have done? The answer is not difficult to seek. So long as there is control on the selling price of fertilisers and consequently, payment of subsidy is involved, we need to refrain from any action that means "artificial" increase in the cost of production. Depreciation/devaluation of the Rupee is no exception particularly when it is realised that important raw materials and intermediates in fertiliser production have to be "necessarily" imported because the country does not have them and that unstinted efforts to develop alternatives have not so far yielded tangible results. When finished fertilisers are perceived as essential items and qualify for import at official rate of exchange, there is no reason why even raw materials and intermediates which go in to their production should not be given the same treatment. Unfortunately, what has been done to them is even contrary to the basic rules of the game.