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To subsidise or not?

Uncertain policy environment is adversely affecting the fertiliser industry, says **Uttam Gupta**

RECENTLY, the Prime Minister hinted that his government was working on an alternative to fertiliser subsidy. Till such time that the alternative is implemented, he proposed continuation of the subsidy. However, Mr Rao had maintained a veiled silence on the important question of how long as also on the quantum of subsidy.

The report of the Joint Parliamentary Committee (JPC) on fertiliser pricing had recommended continuation of control and subsidy on urea while, at the same time, recommending removal of pricing and distribution controls on phosphatic and potassic fertilisers. The government had implemented these recommendations.

The JPC had also recommended several measures aimed at reducing the burden of fertiliser subsidy e.g., reduction in the price of natural gas, removal of royalty on gas, etc. Most of the recommendation have already been implemented. All this does not however, constitute an alternative to fertiliser subsidy.

The acceptance of the JPC report by the Cabinet in August, 1992, had hinted at an era of stability in the fertiliser policy environment. Under the proposed dispensation, while production, sale, disribution and pricing of phosphatic materials were to be guided by the free market, the nitrogenous fertilisers were to remain under control. This expectation was shortlived.

For decontrolled fertilisers, controls came back through the indirect route. In the name of ad hoc subsidy, the state authorities were fixing selling prices. The unrealistically low prices meant a forced loss for the manufacturers, leading to plant closures. In March/April 1993, majority of the DAP/complex phosphatic plants had to be closed. Godavri Fertilisers & Chemical's plant at Kakinada is in the red now despite being one of the most efficient plants.

Producers of nitrogenous fertilisers are also suffering because subsidy payments under the retention pricing scheme are not regular. This is caused partly by inadequate allocation in the Union budget. Besides, the revised retention prices for the sixth pricing period which commenced from April, 1, 1991, have not been notified as yet, even though the pricing period will end shortly (March 31, 1994). The implication is that they continue to incur heavy losses.

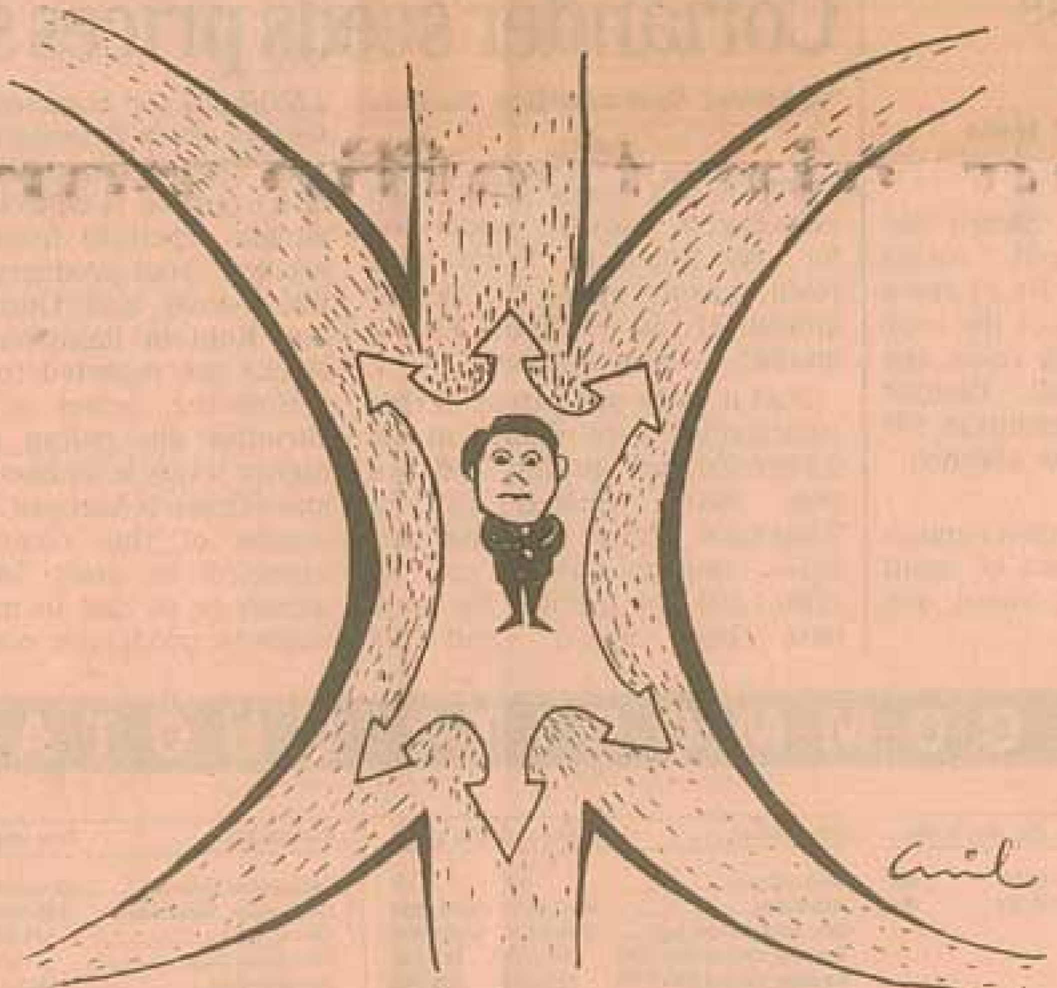
For the last two years, the units' production operations have been somehow sustained by ad hoc cash credit from the banks. But that arrangement may not continue for long as, in principle, the RBI may have reservations about financing subsidy dues from the government.

The JPC had recommended inter alia speedy finalisation of the retention prices for the sixth pricing period as also timely payment of subsidy to the fertiliser units. The report is more than 16 months old and so is the government's declared commitment to implement these recommendations. However, concrete action is yet to be taken.

It is crystal clear that viability of new investments is critically dependent on continuation of the retention price and subsidy scheme. Chambal Fertilisers and Chemical's ammonia/urea plant at Kota has recently started commercial production. Two more projects of the size of Chambal are lined up and will be commissioned in the next one or two years. Expansion of the existing plants of IFFCO-Aonla and NFL-Vijaipur have also been approved on the basis of profitability projections under the retention pricing and subsidy scheme.

A question mark on the fertiliser subsidy scheme at this juncture will jeopardise all these new projects including the approved expansions. Further investments which India desperately needs in this industry may not be forthcoming. The eighth plan working group on fertilisers has projected a deficit of about 17 lakh tonnes of nitrogen by 1996-97. The shortfall cannot be bridged even if the necessary projects are taken up for implementation right away.

Talking of the alternative, we need to distinguish between two situations: Reduction of subsidy or its elimination altogether. The former presupposes that the existing dispensation of control will not be disturbed. Subsidy reduction can be achieved either by increasing the controlled selling price or lowering the cost or a combination of both. Cost reduction is very much unlikely. Declared intentions like the recent gas price hike make this abundantly clear.



Increase in selling price is a good option. With a 10 per cent increase in the urea selling price, the government would save about Rs 400 crore per annum. An increase of 25 per cent which sounds reasonable against the backdrop of the high ruling price of fellow nutrients i.e. P & K, will thus give a substantial saving of about Rs 1,000 crore.

For complete elimination of subsidy also, we need to make a further distinction. The objective can be achieved by retaining the retention price scheme and controls or alternatively by abolishing it. In the former case, all that the government needs to do is to raise the controlled selling price to the level of the weighted average cost of production and distribution for the industry i.e. about Rs 5,000 per tonne.

In the above arrangement, units whose cost is lower than this figure, will contribute money to the exchequer and those which are above this level will draw on the exchequer. The inflows will take care of the outflows, obviating governmental support. The only danger is that the resultant steep increase in the selling price will seriously affect consumption.

Alternatively, the zero subsidy objective can also be achieved by totally abolishing the price and distribution controls. In this dispensation, the government is no longer in the picture and the manufacturers are free to decide price and distribution as per market forces. Herein, the dangers are even more as, apart from consumption getting adversely affected, even production may suffer seriously. Even at a market determined price of Rs 5,000 per tonne urea, some of the new plants including NFCL, Chambal Fertilisers etc. may not survive due to their high capital cost disadvantage.

Whatever option the government may prefer, it should be announced without further loss of time. This uncertainty is having adverse repercussions on production activity and corporate decision-making. Several companies are seeking to tap the capital market both in India as well as abroad to mobilise funds for their expansion, modernisation and diversification programmes. Uncertainty of policy can seriously jeopardise such prospects.

The issue of fertiliser pricing and subsidy has already been examined threadbare. Various options as also their implications are available. The macro-economic compulsions of the government are also sufficiently clear. The prime need of the hour is for the government to act fast so that industry and the investors including foreign ones, can take appropriate decisions and implement them within the required time frame for meeting the challenges of increasing fertilisers demand ahead.