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FERTILISER SUBSIDIES—PROS AND CONS

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Seeds of fertiliser subsidy were sown in the very acceptance and implementation of the Marathe Committee recommendations way back in 1976-77.¹ Though the element of subsidy was inherent in the Committee's recommendations itself, the prospective magnitude of fertiliser subsidies could not be anticipated. The entire arrangement aimed at simultaneous promotion of production through adequate return to both low cost and high cost fertiliser units and sustained growth of agriculture through making fertilisers available to farmers at affordable uniform prices through out the country. It is this latter emphasis that led to increasingly heavier subsidies with every increase in fertilisers' consumption and cost of production.

Magnitude of Fertiliser Subsidies

Subsidies on fertilisers mounted from Rs. 381 crore in 1981-82 to Rs. 4989.3 crore in 1990-91 comprising Rs. 3730 crore on indigenous production and Rs. 659.3 crore on imported fertilisers. Revised budget estimates for 1991-92 made a net provision of Rs. 4937.58 crore and the 1992-93 budget provided Rs. 5027.38 crore for fertiliser subsidy as against an estimated requirement of Rs. 8000 crore without any revision in fertiliser prices.² However, a lot of changes regarding price and distribution control on fertilisers and fertiliser related subsidies have taken place since then.

Even after a 30 percent hike in fertilisers' prices effective from Aug. 14, 1991 for other than small and marginal farmers, the budgeted fertiliser subsidy for 1991-92 was officially estimated at Rs. 4450 crore, which was later stepped up by Rs. 450 crore to facilitate exemption of small and marginal farmers from the price hike. The actual subsidy increased to Rs. 6200 crore for 1991-92 due to various unaccounted variables: e.g. devaluation of rupee, continuation of gulf charge, increase in the prices of feedstock, coal, railway freight hike etc. But for the fertilisers' price hike the subsidy would have gone up to Rs. 7000. Budgetary subsidy provision for 1992-93 is Rs. 5000 crore in-

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cluding Rs. 1500 crore on imported fertilisers. Of the imported element, approximately Rs. 600 crore each is utilised for phosphatic and potassic fertilisers and Rs. 300 crore to subsidise urea imports. It was estimated that in the absence of some of the corrective measures adopted later during 1992-93, the direct and indirect fertiliser subsidy for the period could balloon up to Rs. 8000 crore. During the eighties the share of fertiliser subsidy in total subsidies went up from 20 per cent to 43 per cent. There are additional subsidies for backward regions and scheduled castes and scheduled tribes. Mounting subsidies on food and fertilisers are given in Table 1 and special subsidies for different regions and classes are given in Table 2. Total direct and indirect fertiliser subsidies for 1990-91 were estimated at Rs. 6000 crore. The subsidy is threatening to reach a staggering figure of Rs. 12000 crore on an estimated consumption of 20 million tons of nutrients by 1999-2000 for an estimated production of 240 million tons of foodgrains, having already aggregated to about Rs. 32000 crore for a period 1979-80 to 1991-92; and that too with a rising trend.

TABLE 1: Central Subsidy on Food and Fertilisers (1976-77 to 1991-92)

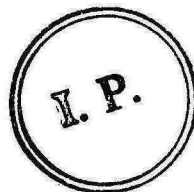
Sl. No.	Year	Food	Fertilisers		Total
			Imported	Indigenous	
1.	1976-77	4,773	N.A.	N.A.	600
2.	1977-78	4,801	2,410	250	2,660
3.	1978-79	5,694	1,710	1,722	3,432
4.	1979-80	6,000	2,830	3,208	6,038
5.	1980-81	6,500	3,350	1,700	5,050
6.	1981-82	7,000	1,000	2,750	3,750
7.	1982-83	7,110	550	5,500	6,050
8.	1983-84	8,350	1,420	9,000	10,420
9.	1984-85	11,010	7,273	12,000	19,273
10.	1985-86	16,500	3,237	16,000	19,237
11.	1986-87	20,000 *	1,971	17,000	18,971
12.	1987-88	22,000 *	1,140	20,500	21,640
13.	1988-89	22,000 *	2,010	30,000	32,010
14.	1989-90	24,760 *	7,710	37,710	45,420
15.	1990-91	24,500 *	6,593	37,300	43,893
16.	1991-92	(a)@ 18,000	12,000	33,000	45,000
		(b)* 26,000	11,000	33,500	44,500
					+450
					for small and marginal farmers

@ = Budget Estimates

* = Revised Budget Estimates

TABLE 2: Subsidy on Fertilisers and Soil Conditioners

Zone/State	Fertiliser & Soil Conditioners	Subsidy
East		
1. Arunachal Pradesh	Urea, SSP, MOP, Ammonium Sulphate, DAP, CAN Rockphosphate, Limes	50% for developed areas. 75% for partially developed and border areas.
2. Assam	All-fertilisers Soil Conditioners	50% tribal plan scheme. 50% Scheduled Caste Component Plan Scheme. 100% Tribal Sub Plan Scheme 100% Scheduled Caste Component Plan Scheme 75% Plan Scheme
3. Tripura	All fertilisers	100% Transport Subsidy 25% on Cost Price
4. Manipur	Urea DAP MOP Rockphosphate CAN SSP 16% P ₂ O ₅	12.5% 25.15% 18.47% 42% 15% 20%
5. Meghalaya	DAP & SSP	Transport subsidy from Calcutta @ Rs. 71 per ton on SSP and Rs. 126 per ton on DAP.
6. Mizoram	Urea, SSP, MOP, Bone meal, Suphala, Slaked lime	50%
7. Nagaland	All fertiliser	50%
8. Sikkim	Urea, DAP, MOP, Suphala & Rockphosphate Dolomite	40%
9. Andaman & Nicobar Islands	Nitrogen Phosphatics Potassic	100% 15% Cost 25% Cost + 100% Transport Subsidy
North		
1. Himachal Pradesh	Fertilisers	40% subsidy on nitrogenous, phosphatic and potassic fertilisers
2. Jammu & Kashmir	Fertilisers	50% of NPK fertilisers



(Contd.)

TABLE 2: (Contd.)

Zone/State	Fertiliser & Soil Conditioners	Subsidy
3. Uttar Pradesh	Soil conditioners	75% subsidy to all farmers under Central Govt Land Reclamations Programme in 25 district. 75% subsidy to farmers having less than 3 hectares of land, and 50% subsidy to all farmers under State Govt. Land Reclamation Programme in 9 districts.
4. Haryana	Soil conditioners	75%
5. Punjab	Soil conditioners (gypsum)	50% to all farmers 75% to small and marginal farmers under IRDP
South		
1. Andhra Pradesh	P_2O_5 and K_2O	25% and $33\frac{1}{3}\%$ subsidy respectively to the small marginal farmers on the cost of all agricultural inputs inclusive of P_2O_5 and K_2O upto a maximum of Rs. 3000 per year under various schemes.
	N, P_2O_5 & K_2O	50% subsidy to farmers of SC/ST in the category of small/marginal farmers covered under Watershed Development Scheme.
	Soil conditioners	Gypsum is generally given under the National Oil Seed Development Programme at the rate of Rs. 75 to Rs. 100 per hectare.
2. Kerala	Fertilisers & soil conditioners	Subsidy at the rate of Rs. 100 per hectare in cash to paddy cultivators who own upto two hectare of land in Kuttanad and Kolelands and to those who own upto one hectare in other areas as a continuing scheme.
3. Pondicherry	Fertilisers and other inputs	At the rate of Rs. 200 per hectare limited to small and marginal farmers (Drought and Flood Relief Scheme).

(Contd.)

TABLE 2: (Contd.)

Zone/State	Fertiliser & Soil Conditioners	Subsidy
3. Pondicherry	Soil conditioners	50% subsidy to the general category and 100% to scheduled caste farmers for the purchase of Gypsum under reclamation of saline and alkaline soils on the basis of soil sample analysis result.
4. Tamil Nadu	Soil conditioners	Zinc sulphate — 50% of the cost. Gypsum — 50% of the cost.
West		
1. Rajasthan	Soil conditioners	75% to small and marginal farmers who are scheduled cast and scheduled tribes. 75% to all other farmers.

Note:

1. A Government of India subsidy scheme is in operation beginning Rabi 1979-80 for the purchase of seeds, fertilisers and pesticides ranging from 25% in the case of small farmers, 33 ¹/₃ % in the case of marginal farmers and 50% in the case of scheduled tribes.
2. There is no subsidy on fertilisers and soil conditioners in the states of Western Region comprising Gujarat, Madhya Pradesh, Maharashtra, Goa, Daman & Diu, Dadra & Nagar Haveli, and in Bihar, Orissa, West Bengal and Karnataka.

As a matter of fact the industry is enjoying a much higher subsidy because it also has the benefit of indirect subsidies through the system of differential pricing with reference to feedstock and fuel. The issue price of naphtha for a non-fertiliser unit was Rs. 3211 per ton during 1989 compared to Rs. 1912 per ton for the fertiliser industry. Similarly the issue price of furnace oil was Rs. 2903 per kl for non-fertiliser units but Rs. 1320 per kl. for fertiliser units. During 1991-92 fertiliser units paid Rs. 2725 per ton for naphtha, a price about 60-65 per cent less than that paid by other consumers.³ There are also no excise and import duties levied on fertilisers.⁴ If one takes into account all these benefits imparted to the fertiliser industry, the existing annual subsidies for 1991-92 may approximate Rs. 8000 crore. This mounting subsidy burden on the exchequer, already heavily strained, is rightly causing concern to the Government and economic planners. It is, therefore, necessary to understand how and why these subsidies grew and can there be an escape from fertiliser subsidies?

Nature and Causes of Fertiliser Subsidies

Fertiliser subsidies were introduced as a temporary measure in the seventies. They have now come to stay and form a major component of total subsidies.

Initially subsidies were necessitated due to high cost of imported fertilisers. After 1975-76, both imported and domestic fertilisers were subsidised. The subsidy on indigenous production started increasing since 1977 under the RPS introduced for all plants in the country because the share of high cost modern plants increased with every expansion in fertiliser capacity. Over a period the share of subsidy on imported fertilisers declined and that on domestic production increased upto 85 per cent in 1990-91 due mainly to high investment cost of new plants, escalation in the prices of feedstock, increased cost of fertiliser distribution and high volume of fertiliser production in the wake of more or less stagnant fertiliser prices to the farmers.⁵

The case of fertiliser subsidies is very much different from subsidies to sustain a sick unit or to support an industry suffering from inefficiencies and obsolete technology. In the case of fertilisers, it is paradoxical that with phenomenal growth and increase in capacity utilisation⁶ the subsidies on fertilisers are increasing. In the case of urea, the most commonly used fertiliser, for a full decade the price paid by the farmer remained constant at Rs. 2350 per ton, or even lower if 7.5 per cent discount on this price is taken into account. An increase of 30 per cent was announced in August 1991, and that too for farmers other than small and marginal farmers. However, during the decade the cost of production of urea from new plants nearly doubled. These cost escalations were due to escalation in capital cost as well as that of the cost of feedstock. Major feedstocks are naphtha, coal, fuel oil and natural gas. Between July 11, 1981 to July 25, 1991, though fertiliser (particularly urea) prices remained more or less constant, price of naphtha increased from Rs. 1481.57 per ton to Rs. 2725.68 per ton and that of fuel oil went up from Rs. 1311.37 per ton to Rs. 1815.33 per ton (see Table 3).

TABLE 3: Increase in the Price of Naphtha and Fuel Oil from 11.7.81 to 25.7.91

	Naphtha (Rs. per ton)	Fuel Oil (Rs. per kilo litre)
11.7.1981	1481.57	1311.37
15.2.1983	1723.31	1274.06
17.3.1985	1982.31	1148.06
15.10.1990	2477.89	1320.06
25.7.1991	2725.68	1815.33

With every increase in the price of fertiliser inputs, the subsidy burden increased due to increased production of fertilisers sold at near stable prices. The Government's attempt to give remunerative prices even to high cost fertiliser plants, based on Marathe Committee recommendations, without passing on to the farmers the burden of such high costs, also led to heavy subsidisation in a situation where per ton cost of high cost units has been five times higher than that of the low cost units due to considerations of feedstock, vintage and other factors. For example, comparative production cost during 1991-92 of four fertiliser plants in the public/cooperative sector itself varied between Rs. 3268.74 per ton in the case of naphtha based Phulpur plant of

IFFCO to Rs. 11601.19 per ton for coal based Ramagundam plant of Fertiliser Corporation of India (see Table 4); and both these units are granted a retention price to yield 12 per cent post-tax return on net worth based on their respective normative cost structure.

TABLE 4: Cost of Production of Fertiliser Plants Based on Different Feedstocks

Sl. No.	Name of unit	Plant capacity	Year of establishment/date of commercial production	Capital cost of the project (Rs. crore)	Cost of production (Rs./Ton of Ammonia 1989-90)	Feed-stock
1	2	3	4	5	6	7
1.	IFFCO, Phulpur	Ammonia 900 TPD Urea 1500 TPD	March, 1981	205.00	3268.74	Naphtha
2.	NFL, Panipat	Ammonia 900 TPD Urea 1500 TPD	1st Sept. 1979	223.50	4042.89	Fuel Oil
3.	FCI, Ramagundam	Ammonia 900 TPD Urea 1500 TPD	1st Nov. 1980	217.90	11601.19	Coal
4.	RCF, Trombay-V	Ammonia 900 TPD Urea 1000 TPD	1st July 1982	166.09	4133.00	Natural Gas

In view of the cost-plus retention prices to the producers and much below-cost prices to the farmers, the subsidies are bound to increase with every increase in production and consumption of fertilisers,⁷ even if the highest standards of efficiency are maintained.

It must also be remembered that fertiliser subsidies are not subsidies to the fertiliser industry but to marginal farmers producing for self consumption, and to the poor masses without adequate purchasing power to buy their minimum food requirements. The fertiliser industry is merely a conduit for efficiently distributing the benefit of this subsidy. The Fertiliser Industries Coordination Committee (FICC) which is administering RPS and thus handling fertiliser subsidies is performing the task involving an annual expense of only Rs. 25 lakh. Subsidy gains are only channelised through the industry for ease of administration and cost optimisation. Subsidy arises only because the selling price does not cover even the variable and the utility cost in the manufacture of fertilisers.⁸

Per ton subsidy as well as total subsidy has increased at a faster pace during the recent past because of rapidly rising input costs and increasingly larger quantum and percentage share of total fertiliser production coming from newly commissioned plants, which entail substantially higher investment cost per ton vis-a-vis old vintage plants and consequent additional charge towards cost of servicing the capital.⁹

Fertiliser Subsidies – Pros and Cons

Despite the fact that the above factors responsible for increase in fertiliser subsidies are well understood, the very need for subsidisation is at times questioned. Total fertiliser consumption by the class of farmers having no marketable surplus of foodgrains is only about 10 per cent of the total nutrient consumption in the country. Thus, while the justification put forward for keeping fertiliser prices low is ostensibly to subserve the interest of marginal farmers, 90 per cent of the benefit goes to those who do not deserve any subsidy. Even if the total farm holdings below 1 hectare are taken (and all of these are not marginal farmers without marketable surplus), they constitute 41 per cent of total cultivator households but consume only 12 per cent of total fertilisers, proving that the benefit of fertiliser subsidy to marginal farmers is insignificant.

It is argued that an increase in fertiliser subsidy does not necessarily enhance the welfare of the society. It is contended that the immediate and direct consequence of a subsidy reduction obtained by a hike of say 30 per cent in fertiliser prices would lead to a 14 per cent reduction in fertiliser use and a 3.4 per cent reduction in foodgrains output¹⁰. However, the resources released from fertiliser subsidy are then available for additional investment elsewhere leading to an increase in growth rate in those sectors. But this higher growth in other sectors may not be adequate to compensate the poor for the welfare loss due to a loss in income of the agricultural population and lower foodgrain production. Subsidy reduction, therefore, requires compensatory rural works programmes and development of additional irrigation facilities targeted at the poor farmers and backward areas.

An argument for maintaining, even promoting, fertiliser subsidy is to induce more intensive fertiliser use for promoting faster agricultural growth assuming that the fertiliser demand is highly sensitive to price changes. However, fertiliser price is not the only factor determining its demand. For instance, between 1973-74 and 1986-87 fertiliser consumption increased to more than three times even when the terms of trade (in terms of kilograms of paddy and wheat required to buy one kg. of N) had not changed favourably.

The impact of an increase in fertiliser price on fertiliser use, yield and output is indicated by the elasticity of yield with respect to fertiliser price. Available estimates of such elasticities are less than (-)0.3, indicating that a 40 per cent increase in fertiliser price will reduce rice and wheat output by less than 12 per cent. The reduction in foodgrains output may be even much less because the increase in foodgrains prices will lead to a reallocation of resources and a favourable supply response for these crops.

A reduction in fertiliser prices does not automatically push up the fertiliser consumption which simultaneously requires complementary inputs like HYV seeds and irrigation in addition to being influenced by technological improvements, procurement price policy and efficiency of other non-price factors. Moreover, fertilisers constitute not more than 7 per cent of the total cost of agricultural production as fixed for procurement prices.¹¹ Thus, fertiliser

prices alone do not guide their consumption though it is one of the influencing factors. Whenever there was a sudden increase in fertiliser prices, as in 1974 and 1980, either the fertiliser consumption declined as in 1974 or the growth in consumption slowed down as in 1980 and 1981.

Complete abolition of fertiliser subsidies would require 100 per cent increase in pre-budget prices of fertilisers which would result in 15 per cent increase in total input cost to the farmer and farm production could be protected by raising procurement prices of foodgrains by 10 per cent. The question, however, arises regarding ensuring output from small and marginal farmers and safeguarding their interest who neither have adequate resources to buy agricultural inputs at 'full cost plus', nor can they be compensated through higher procurement/support prices of agricultural crops as they seldom enjoy any marketable surplus, the impact of high procurement prices on general inflation and poor consumers notwithstanding.

It is estimated that if the subsidy on fertilisers is totally abolished the actual impact on the poor consumers would be barely 6 paise per kg. on their purchase of rice and wheat.¹² Moreover, the growers of cash crops like cane, cotton, tobacco and groundnut are also well aware that the use of fertilisers will be profitable even at higher costs. Fertilisers as part of the high yielding seed cum fertiliser cum irrigation strategy, undoubtedly contributed significantly to the green revolution; the strategy has now peaked out and is self sustaining at a higher level. However, this argument is flawed because what is true of the average may not be true of each item in the population. Free pricing unshackled by varying retention prices and uniform issue prices for different fertilisers, is bound to hit different farmers differently because fertiliser cost in total farm costs is not uniform across crops and regions. Size of holding and irrigation or lack of it further complicates the issue. For example, fertiliser constitutes less than 5 per cent of the cost of cultivation in the case of Arhar in U.P. whereas for sugarcane in Maharashtra, it could be as high as 12 per cent. Again, for the wheat crop in Haryana, fertiliser cost could be as high as 15 per cent of the total cost of cultivation while in Madhya Pradesh it may be less than 10 per cent. As a result the impact of subsidy removal may be excessive and crippling in certain areas and on certain crops.¹³

A case against fertiliser subsidy is also made on the ground that these have contributed to agricultural disparities. Almost all fertilisers are consumed in the irrigated areas accounting for less than 32 per cent of India's gross cropped area. As a result, 10 per cent of all fertilisers are consumed in just 8 of India's richest districts. They have, thus, widened the disparities between the irrigated and the rain-fed areas of the country. Fertiliser subsidies have contributed nothing to the areas that groaned under greatest poverty. Fertiliser subsidy per hectare varies widely from a high of Rs. 187 in Punjab, Rs. 113 in Tamil Nadu, and Rs. 89 in Haryana, to a low of Rs. 20 in Orissa, Rs. 16 in Rajasthan and Rs. 5 in Assam. Irrigation and power subsidies are respectively Rs. 910 and Rs. 278 for Punjab but only Rs. 107 and Rs. 12 for Assam. The agricultural input subsidy policy including the fertiliser subsidy has favoured the more developed regions. Though fertiliser subsidisation has

widened disparities between irrigated and rain-fed areas, it has helped containing income disparities between large and small farmers in particular areas. Per hectare application of fertilisers is more in smaller farms than on the larger ones. Even in unirrigated areas, where the use of fertilisers tends to be comparatively low, the smaller farms tend to be more intensive users of fertilisers. Removal or drastic curtailment of fertiliser subsidies will, thus, lead to greater curtailment of demand from smaller farmers and they will be the worst hit.

It is also variously suggested that the recourse to larger imports is another option to meet demand for fertilisers with simultaneous reduction in the subsidies. However, it should be remembered that even imported fertilisers involve subsidy which was budgeted at Rs. 1,500 crore in 1991-92 and may go up still further in future in case indigenous capacities are not significantly expanded. There are a number of other problems of placing excessive reliance on cheaper imports as a substitute for indigenous capacity expansion. International prices are volatile and the supplies unreliable. The more urgent the domestic need of big countries like India and China become, the higher the level international prices attain. Moreover, an extremely tight foreign exchange situation in the country, likely to emerge again when the repayment of the existing large international borrowing commences, may make increased imports even more difficult.

Alternatives to Fertiliser Subsidies

A sharp increase in fertiliser subsidies during the eighties has led to a rethinking regarding the operation of RPS and continuation of fertiliser subsidies. A number of alternatives to fertiliser subsidy, such as total removal of price control, sharp increases in fertiliser prices while retaining governmental control, gradual annual hike in fertiliser prices, dual pricing, elimination of transport subsidy and import parity prices etc. have been analysed below.

Total lifting of price control and, therefore, total removal of fertiliser subsidy would lead to near doubling the fertiliser prices in different regions. It is evident from the past experience that though price is not the sole factor governing the fertiliser use, it definitely had an impact on fertiliser consumption and hence, on agricultural growth in a situation where about 56 per cent of increase in productivity is attributed to more intense use of fertilisers. To learn from the experience of other countries, sudden withdrawal of the subsidy through decontrol of fertilisers dampened agricultural production in Poland where an immediate fall of 12% in fertiliser consumption in 1990 and another 25% in 1991 brought down the level of foodgrains self-sufficiency.¹⁴ The World Bank may hold the view that India's subsidies and price policy "have contributed to a number of distortions, including excessive and imbalanced use of fertilisers, which depletes soil and leads to contamination of water tables; switches from other crops to cereals . . . as well as having implications for income distribution" (World Bank Study 1990). However, the fact remains that per hectare consumption of fertilisers in India is still low

compared to many countries. Increases in foodgrains production to feed a population growing at a rate of more than 2 per cent requires a continuous push to agriculture through low input costs including that of fertilisers. Throughout the developing world the growth rate of fertiliser consumption is more with subsidy than without subsidy as shown in Table 5.

TABLE 5: Growth Rate in Fertiliser Use vis-a-vis Subsidy

Country	(Per cent per year)	
	with subsidy	without subsidy
1. Africa	16.2	8.9
2. Asia	19.6	10.2
3. Near East	11.0	6.9
4. Latin America	13.2	7.8

Given the present state of development in many developing countries, fertiliser subsidies are inescapable and could be construed as a necessary price the country has to pay for building-up a self-reliant agriculture. All countries, including the developed countries, have certain priorities and follow appropriate agricultural price support programmes to meet them.¹⁵ The per capita food subsidies in EEC was \$ 182.2, Japan \$ 165.6, and the U.S.A. \$ 108.9 in 1986-87 compared to a meagre \$ 3.72 in India (see Table 6).

TABLE 6: Farm Price Support in Developed Countries vis-a-vis India

Country	(1986) price support (\$ billion)	Total population (million)	Price support per capita (\$)
	(1)	(2)	(3)=(1)/(2)
EEC	48.0	263.5	182.2
Japan	20.0	120.8	165.6
U.S.A.	26.0	238.8	108.9
India	2.85*	766.0	3.72

* 1987 Budget provision for fertiliser and food subsidy

In fact the total farm subsidies granted by the developed countries — the European Community, the U.S.A. and Japan are regularly on increase. In Japan though the total annual farm subsidy was on an average US \$ 22 billion between 1979-86, it increased to US \$68 billion in 1990 amounting to 68 per cent of the total value of agricultural production. In India, on the other hand, annual farm subsidy increased from US\$2 billion in 1979-86 to only US\$3.7 billion in 1990 amounting to just 5.3 per cent of the value of agricultural production. In per capita terms the farm subsidy in India was only US\$4.4 in 1990 compared with \$260 in Japan, \$240 in European countries and \$149 in

the U.S.A. (see Table 7). For India achievement of food self-sufficiency, welfare of poor farmers and general masses and price stabilisation is more important than adherence to any doctrinaire free market approach.

TABLE 7: Farm Subsidy — International Comparison

	Annual Average			% of agricultural production	Population (million)	Per capita subsidy (US\$)
	1979-86	1989	1990			
	(US\$ billion)					
EC	40	62	82	48	343	240
U.S.A.	30	35	37	30	248	149
Japan	22	37	32	68	123	260
India	2	4.2	3.7	5.3	850	4.4

Source: The Economist, June 8-14, 1992, p.116

Figures for India computed.

Removal of controls and fertiliser subsidies entails the risk of decline in fertiliser consumption and agricultural production. Total production of fertilisers, optimum use of various feedstocks and equitable distribution of fertilisers would also suffer. Even the modernisation of existing plants and their expansion will be adversely affected due to their much higher capital costs.

Removal of freight subsidy would lead to sharp differences in the price of fertilisers in different districts, hitting hard those located far away from fertiliser plants. In fact, the government has consciously adopted a policy of freight equalisation for a number of heavy and bulky essential intermediates.

Import parity pricing would also serve only a negative purpose in the case of fertilisers. First of all, even such pricing would involve heavy subsidisation. Secondly, in many cases these prices being very low due to low input costs to foreign plants and also on account of dumping practices, such pricing may lead to near total abandonment of even existing capacities. Once this happens, the exporters may hike the fertiliser prices to a prohibitively high level causing unbearable strain on the foreign exchange resources, crippling agriculture and perhaps the entire economy.

Dual pricing as an alternative to subsidy, is based on the notion that the rich farmers are the major beneficiaries of fertiliser subsidies and that they can be made to subsidise small and marginal farmers under a scheme of differential pricing. Both these notions are untenable. Only 11.2 per cent of total fertiliser consumption is by farmers holding a farm of above 10 hectare and 40 per cent of the consumption is by farmers holding a farm of above 4 hectare constituting just 15 per cent of total farm households. In case the poorest 85 per cent of farmers are to be supplied fertilisers at the existing retail price and the entire deficit in cost is recovered from the richest 15 per cent farmers, the price differential may be in the ratio of 1:3 making it totally unviable for big cultivators resulting in a drop in agricultural production and non-recovery of deficits leading to huge uncovered subsidies. Moreover, weather uncertainties

may induce small farmers to sell their quota of fertilisers to large farmers at a premium, thereby defeating the very objective of the system. Dual pricing in the case of fertilisers is administratively difficult and thus costly to operate.

An alternative the Government could seriously consider is the GVK Rao Committee recommendation regarding periodical gradual increase in fertiliser prices keeping in mind the level of foodgrains production and such other factors. Even the BICP's recommendation of across the board 10 per cent hike per year appears to be on the higher side in view of prevailing purchasing power position of small and marginal farmers.

Government Dithers on Fertiliser Subsidies

The years 1991-92 and 1992-93 caught the Government of India dithering on the issue of fertiliser subsidies — one step forward followed by the next step backward. During 1991-92 budget the Government proposed an increase of 40 per cent in fertiliser prices so as to drastically cut the subsidy. Before putting the proposal to vote various pressures forced the Government to restrict the price increase to 30 per cent; small and marginal farmers were totally exempt from paying the higher price. On Aug. 20, 1992, the Joint Parliamentary Committee (JPC) under the chairmanship of Pratap Rao Bhonsale proposed removal of price and distribution control on phosphatic and potassic fertilisers, rejected total decontrol of fertiliser prices and distribution, and suggested a 10 per cent cut in the urea price from the prevailing level of Rs. 3060 per ton. The Committee also suggested a 35 per cent reduction in the price of natural gas being supplied to fertiliser plants and rationalisation of tax structure concerning fertiliser production. The objective was to bring down the annual fertiliser subsidy to around half so as to reverse the trend of mounting fertiliser subsidies which aggregated to Rs. 28285 crore during the decade 1981 to 1992.

The Committee argued that the extent of subsidisation of the phosphatic and potassic fertilisers was very high and the likely subsidy saving through decontrol of these fertilisers would be substantial. Simultaneously, the Committee suggested that the Government should provide certain concessions, like reduction in railway freight, cheaper inputs and abolition of import duties on raw materials to guard against prices of phosphatic and potassic fertilisers shooting up after decontrol. A suitable increase in procurement prices to compensate farmers for the resultant increase in cost was also recommended. The net result of these recommendations was that while direct fertiliser subsidies on phosphatic and potassic fertilisers were expected to be reduced by Rs. 4500 crore, an additional subsidy of Rs. 400 crore on urea together with increase in food subsidies and that on railway freight, gas and other inputs, and a reduction in revenues from import duties etc. was also built in the scheme.

Following the JPC recommendations, the Government announced decontrol of phosphatic and potassic fertilisers on Aug. 26, 1992 estimated to result in annual fertiliser subsidy saving of Rs. 3356 crore — Rs. 1200 crore on

imported fertilisers and Rs. 2156 crore on indigenous production of these fertilisers assuming that 44 per cent of total subsidy bill is used to subsidise phosphatic fertiliser production, the entire potassic fertiliser requirement being imported.

The Government took a number of steps to neutralise adverse impact of decontrol. The import of phosphoric acid for manufacture of fertilisers has been completely exempted from import duty resulting in a revenue loss of Rs. 240 crore in a full year. The cumulative duty on phosphoric acid, which was 15 per cent, has been reduced to nil. The Government has also allowed import of fertiliser raw materials at official exchange rates, favourable changes in freight category, exemption of capital goods for expansion and modernisation of fertiliser production from import duty, and decanalisation of import of DAP (diammonium phosphate), all the measures directed at benefiting the farmers who are expected to pay higher prices for fertilisers after decontrol. Residual impact of price hike has been compensated by subsequent hike in procurement prices of foodgrains. A full circle of subsidy reduction to subsidy expansion thus gets completed.

Despite these balancing acts the price of diammonium phosphate fertiliser shot up from Rs. 4680 per ton to about Rs. 8500, leave alone the impact of hoarding and other market malpractices. Agricultural experts feared that the whopping hike in the prices of phosphatic and potassic fertilisers would reduce their consumption while nitrogen would continue to be used as before. This would accentuate the already grave imbalance in the use of three major plant nutrients — nitrogen, phosphorous and potash. Already nitrogen constitutes about two-third of total consumption of fertilisers against the suggested all-India average proportion of 2:1:1, the proportion on particular farms varying according to the characteristics of soil, nature of crop and other conditions. Imbalanced use of fertilisers would have an adverse impact on soil fertility, crop productivity and optimisation of resource use.

Another impact of decontrol is that the cost of indigenous DAP of about Rs. 8300 per ton is much higher than the import price of about Rs. 7000 per ton resulting in a gap of about Rs. 65 per bag of 50 kg. The gap will become much larger if the rupee becomes fully convertible. This situation threatens closure of domestic DAP units involving an investment of about Rs. 2500 crore. Moreover, a sudden spurt in enquiries from India led American DAP suppliers to push up the price to \$ 200 per ton for supplies in November and December 1992 from \$ 170 per ton prevailing during early September 1992.¹⁶ The US based DAP cartel is quite capable of beating down prices to keep Indian producers totally out of production, converting them into importing agents,¹⁷ a situation that would jeopardise Indian food security by exposing Indian agriculture to diverse foreign pressures.

Looking at the gravity of the situation, the Central Government during the first week of October, 1992 announced a provision of Rs. 340 crore for States to make phosphatic, potassic and complex fertilisers available to farmers at reduced rates. It is expected that farmers would be granted a concession of Rs. 1000 per ton for diammonium phosphate (DAP) and murate of potash

(MOP), and on an average Rs. 620 per ton on complex fertilisers. This measure has forced fertiliser industry to invoke 'force majeure' clause to cancel orders for 5.5 lakh tons of phosphoric acid valued at \$ 200 million and 4 lakh tons of ammonia costing \$ 47 million because the Indian industry cannot sell DAP at about Rs. 6500 per ton, the price directed by the Government, after importing it at already contracted price.

A lacunae in the subsidy announcement was that the government did not clearly specify that a subsidy of Rs. 1,000 per ton on DAP would be available only if the fertiliser is sold at the retail level at the specified price of Rs. 6,500 per ton and an equal subsidy on murate of potash would be subject to its retail price restriction up to Rs. 4,200 per ton. Industry circles, however, felt that it was not viable to bring the fertiliser prices down to this level.¹⁸ Even the cooperative sector IFFCO, which is one of the most efficient fertiliser enterprise with a high rate of capacity utilisation, could reduce the prices of its DAP and NPK (10:26:26) complex fertilisers to only Rs. 7700 and Rs. 7300 per ton and that for NPK (12:32:16) to Rs. 7100 per ton, and that too exclusive of dealers margin and local taxes, if any.¹⁹ In view of inadequacy of these measures to neutralise the plight of the farmers, the Prime Minister felt obliged to announce a special assistance of Rs. 500 crore to small and marginal farmers to adequately compensate them for withdrawal of the subsidy on fertilisers.²⁰

The Government also announced an increase in the administered price of fertiliser feedstock—naphtha price hike by Rs. 1050 per ton and fuel oil price increase of Rs. 1122 per ton. Since about 3.6 million ton of urea is produced through naphtha route, the higher naphtha price is expected to notch up Rs. 230 crore by way of incremental subsidy. Similarly an additional subsidy burden of about Rs. 150 crore is estimated due to fuel oil price hike as about 2.30 million ton of nitrogenous fertilisers use fuel oil as feedstock. An additional Rs. 30 crore burden will be imposed due to the impact of the feedstock price hike on complex nitrogenous fertilisers like ammonium sulphate and ammonium chloride. The fertiliser department has, thus, estimated that Rs. 400 crore can be saved by way of roll-back of naphtha and fuel oil prices.²¹ These measures reduce cross subsidisation but tend to increase fertiliser subsidies if unprecedented price hike, which in any case is imprudent—economically, socially and politically, is to be avoided.

Lack of clear thinking on the issue of fertiliser subsidies betrayed by frequent policy changes during 1991 and 1992, as illustrated above, if allowed to persist, would adversely affect the interest of the farmers, the industry and the economy in general. The alternative pricing options to eliminate fertiliser subsidies completely would risk the attainment of the twin objectives of encouraging growth of indigenous fertiliser industry on the one hand, and of accelerating agricultural production through higher consumption of fertilisers without adversely affecting the income distribution and the price stability, on the other. Sharp increases in fertiliser prices to neutralise the cost escalations, whether of indigenous or imported fertilisers would lead to substantial reduction in fertiliser consumption, not only by the small and marginal farmers but

also by the bigger farmers producing for the market. Or else the procurement price of foodgrains will have to be substantially increased, which would hit hard the two-fifth of the total population living below the poverty line. Alleviation of their misery and avoidance of cost-push inflation due to higher price of agricultural crops, would otherwise call for huge foodgrains subsidy. This, in other words, means only converting the shape of subsidy, i.e., fertiliser subsidy transformed into foodgrains subsidy.

To SUM UP, the system of retention prices yielding 12 per cent return on net worth based on specified capacity utilisation and adherence to efficiency norms has induced efficiency in operations, higher capacity utilisation and expansion of capacities by maintaining fertilisers prices at a viable level. The system has simultaneously encouraged larger fertiliser consumption through highly subsidised low prices to the farmers for promoting agricultural production and ensuring availability of food at affordable prices to the poor masses of the country. The fertiliser subsidy, which is not due to inefficient performance of the industry, but has been adopted as an instrument of the governmental policy in furtherance of its goal to maintain self-sufficiency in food and making it within the reach of the poor, should not be viewed in isolation. Viable prices to the fertiliser industry and subsidised prices to the farmers are perfectly justified for promoting the industry, agriculture, employment, balanced distribution and price stabilisation.

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