Frank Notes

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Domestic Manufacturing Needs Policy Support

Indian fertiliser sector took big strides under favourable government policies, especially during the decades of 1970s to 1990s. These policies also resulted in development of world class efficient and competitive domestic fertiliser industry. India achieved near self-sufficiency in production of urea and DAP by end of the decade of 1990s. India also emerged as the second largest consumer of fertilisers (N+P+K) and third largest producer of nitrogen and phosphates in the world.

However, in the subsequent years, Indian policy makers got over-engaged in containing increasing subsidy burden, especially since mid-1990s which distorted the policies. The axe mainly fell on the domestic industry in the form of tightening of operating norms. The policies also ignored the changing needs of Indian agriculture. These included promoting balanced and integrated use of primary nutrients, addressing the deficiency of secondary and micronutrients, restoring organic carbon of the soil, etc.

The results are not far to seek. It seriously impacted major stakeholders. The policies for the sector adversely impacted both the domestic industry and the farmers. Moreover, government is still struggling with management of the increasing levels of subsidy on urea and is unable to settle the dues of the industry in time.

Industry suffered with squeezing operating margins causing closure of several urea units. Half of the urea industry is having negative returns and remaining units are also struggling to keep their nose above water. Large amounts of pending dues of more than Rs.40,000 crores for past several years have resulted in huge financial cost of about Rs.4000 crore per annum seriously impacting viability of domestic fertiliser industry.

The ultimate beneficiary i.e., the farmers also suffer because the existing subsidy policies are causing imbalanced use of primary nutrients with excessive use of urea. Farmers are not getting optimum returns from use of fertilisers. India's import dependence in urea and DAP has increased to 28% and 66%, respectively in 2015-16 from a level of near self-sufficiency in 2000-01.

Such increased level of import dependence in finished fertilisers made it imperative to revisit fertiliser policies to attract fresh investment for boosting fertiliser production in India. Investment in the sector had almost dried up for the past one and half decades. Giving a boost to making fertilisers in India also fits well with the country's flagship programmes 'Make in India' and 'Doubling farmers' income by 2022'. Accordingly, this year's FAI Annual Seminar was devoted to the topical theme of 'Fertilisers – Make in India ?'

Seminar started with presentation in the areas of world supply-demand and price trends of fertilisers. There were detailed presentations on the prevailing policy environment for the sector and its impact on Indian agriculture and industry. Some of the issues debated are briefly enumerated here.

The government had initiated a number of reform process for the sector by introduction of NBS policy for P & K fertilisers in 2010. The present government has taken a number of proactive steps including pooling of gas price for urea, promotion of coated, fortified and speciality fertilisers, neem coating of urea, and formation of Indian Council for Fertilizer & Nutrient Research. But these steps are not adequate to address the issue of imbalanced use of nutrients and high import dependence.

The government has now initiated steps for Direct Benefit Transfer (DBT) to farmers as a major policy reform. The objective is laudable and industry is whole heartedly working with the government for its successful implementation. But, the current model of DBT being implemented on pilot basis in 16 districts does not lead to DBT in true sense, as payment of subsidy continues to be routed through the industry. Moreover, there are serious issues in implementation of pilot project for DBT which have not been addressed due to compressed time frame for implementation. Subsidy payments will get further delayed due to shifting the basis for payment from receipt in the district to sales and also complexities in recording sales records by the retailers. Any fault on part of retailers will cause delay or denial in subsidy to the industry. There is neither any incentives for retailers for doing this additional task nor there is any penalty for errors. Ironically, industry will suffer for errors and omissions/ commissions by the retailers.

Coming to industry issues, urea industry continues to suffer from cost under-recoveries due to non updation of fixed cost after 2002-03. Further, the energy norms have been reduced significantly under NPS-II, NPS-III and NUP-2015 policies, much against the government's avowed policy of neither mopping up any operational efficiency nor recognising capital expenditure for the same. Surprisingly, while mopping up operational efficiencies, the government has not provided any window for recovery of the investment cost incurred for the same.

Thus, the industry has been squeezed from both ends. This is against the normative pricing principles. Particularly, the energy norms proposed under NUP-2015 from 2018-19 onwards with only three categories viz., 5.5 GCal/MT, 6.2 GCal/MT and 6.5 GCal/MT for group I, II and III respectively, are unreasonable and unachievable without significant investment. But the policy has not made any provision for recovery of such costs.

P and K sector continue to suffer from *de facto* controls and interventions in day to day operations despite *de jure* decontrol under NBS policy since 2010. Further, this sector suffers from cost disadvantage in comparison to imports due to same rate of customs duty on raw materials/intermediates and the finished fertilisers. Abhijit Sen Committee in 2005 had recommended additional allowance of upto 20% in fixing subsidy for domestic DAP to cover disadvantage relating to production and higher taxes & duties in India. Government initially provided differential subsidy to the domestic industry. However, due to commitment under WTO, Government resorted to uniform subsidy on imported and domestically manufactured P&K fertilisers under NBS policy. Government can alleviate the cost disadvantage of domestic industry to some extent by exempting or reducing import duty on raw materials.

There is need for making adequate budget provisions for fertiliser subsidy to avoid year end payment crisis every year. Government also needs to make budget provisions for clearing the past backlog of more than Rs.40,000 crores, if not possible in a single year, then at least in a period of two years.

The instrument of subsidy should be used for promoting balanced and integrated use of all nutrients including primary, secondary and micronutrients in combination with bio-fertilisers, organic manures. For this, the issue of relative prices of P and K fertilisers with respect to urea needs to be addressed urgently

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besides encouraging use of secondary and micronutrients.

DBT in true sense needs to be implemented as early as possible where subsidy can be transferred directly to the bank accounts of the farmers. The available technology supports such scheme but, it needs government's firm commitment and support. Government has to expedite the pace of reforms leading to true DBT and finally decontrol the sector. DBT in true sense can be implemented even for urea within the existing policy by pooling of subsidy at FICC level, on lines similar to pooling of gas prices. There is need to address policy as well as operational issues in implementation of DBT even at pilot scale.

However, till direct or indirect price controls continue and the subsidy is routed through the industry, it remains prime responsibility of the government to ensure not only the viability of existing capacities, but also to attract fresh investment for growth and development of the sector. This is where enabling changes in policies with minimum government and effective governance are needed.

Urea industry can be revived by implementing Modified NPS-III Policy and revisiting energy norms under NUP-2015 from 2018-19 to bring them to reasonable and achievable levels. Also, a window to recover the investment for energy improvement is needed. Production of urea beyond reassessed capacity of about 4 million tonnes has become unattractive due to non-updation of fixed cost. Loss of this 4 million tonnes urea will increase import requirement and consequently the international price of urea. The government will then have to pay higher prices and subsidy not only on 4 million tonnes, but on entire import quantum of urea. Encouraging additional domestic production, thus, makes serious economic sense keeping in view their competitive cost and savings in subsidy. New investment policy needs to be made attractive for both debt and equity investors. New projects under controlled regime will not get institutional finance unless the policy ensures adequate returns for servicing the debt and ensures at least opportunity cost of capital for equity investment. Expediting spread of nationwide gas grid covering the locations where new urea plants are being planned, including revival of closed plants, will facilitate fructification of new investments.

P and K segment urgently needs long pending relief in terms of exemption of customs duty on major raw materials/intermediates. This is essential to address the cost disadvantage in comparison to imports and to increase domestic capacity utilisation which has declined from 100% in 1997-98 to 65% in 2015-16 due to viability issues. Further, the market forces be allowed to play in fixing farmers' price as per basic tenets of the NBS policy. Further, liberalisations like merging freight with product subsidy and doing away with monthly supply plan, already been approved by the cabinet, will add confidence in government policies.

In addition to presentations and discussion on issues related to policies for this highly regulated sector, the Seminar deliberations included a number of other presentations covering issues related to conservation of soil & water, speciality fertilisers, efficient technologies for fertiliser production, fertiliser movement monitoring system, etc. The current issue of this journal covers resume of all speeches delivered during inaugural and valedictory functions, resume of all presentations and discussions including major conclusions and recommendations emanating from the Seminar.■