

The Fertiliser Association of India, New Delhi



3rd December, 2018

**Subject: Press Note – FAI Annual Seminar – 2018
on `Making Fertilizer Industry Viable and Vibrant`**

1. Background

- 1.1. Contribution of agriculture to nation's GDP has come down significantly over the years. It is currently at about 17%. However, more than 50% of population both landed and landless depend on agriculture. In addition, it provides food, fodder, fibre and medicinal herbs which sustain human and bovine population. Fertilizer continues to play its role in increasing crop productivity. Application of mineral fertilizers accounts for more than 50% increase in foodgrain production. Domestic fertilizer industry has played crucial role in ensuring supply of mineral fertilizers in every nook and corner of the country. But, what needs to be appreciated is that fertilizer industry is working as conduit for reaching fertilizer subsidy to the farmers for more than 40 years. The understanding of common man and even experts is that government is providing dole to the industry and fertilizer industry cannot survive without such a massive financial support in form of fertilizer subsidy. Industry has been requesting government to decontrol it and provide subsidy directly to the farmers. The present policies for the sector have hurt industry the most. Industry has to collect more than 50% of its revenue from the government. This is almost 75% in case of urea.
- 1.2. Industry spends much time and resources in justifying costs and realising payments. A plethora of policies and procedures has made doing business more and more difficult in the sector.
- 1.3. Following paragraphs bring out certain issues and remedies required to address the same.

2. Contribution of Existing Fertilizer Industry

- 2.1. India is the second largest consumer of the fertilizers in the world with annual consumption of more than 55 million tonnes of fertilizer products. For such a large consumer of fertilizers, a certain degree of self-sufficiency in production of fertilizers is necessary for ensuring sustainable supplies. Further, production of domestic fertilizers has also contributed in saving of subsidy for the country. Indian gas based urea plants have been consistently supplying urea at lower than the cost of imported urea. This has resulted in significant saving of subsidy over the years. An estimate for recent years shows cumulative saving in subsidy has been more than Rs.1,37,000 crore for the period 2006-07 to 2017-18.
- 2.2. Domestic phosphatic and potassic (P&K) fertilizer industry has provided much needed flexibility to meet Indian demand of P&K fertilizers. This can be met either through domestic production based on imported basic raw materials like rock phosphate and sulphur, or based on imported intermediates like phosphoric acid and ammonia or by direct import of finished fertilizers. This flexibility has helped India optimise its cost and supply depending upon the international price trends of fertilizers and raw materials.

3. Issues faced by the Fertilizer Industry

Indian fertilizer industry is not doing well for past several years due to unfavourable policy environment.

3.1 Urea Sector

- 3.1.1 Unreasonable tightening of operational and energy norms, often against the principles of normative pricing: For instance, reassessment of installed capacity in 2000 and successive increase in capacity utilisation norms from 80% to 98% of reassessed capacity reduced the amount of fixed cost per tonne reimbursed to the industry under policy.

- 3.1.2 Implementation of New Pricing Scheme (NPS) from 2003 also reduced the amount of fixed cost reimbursable to the industry due to averaging, as units were allowed either group average or cost of individual unit, whichever is lower.
- 3.1.3 NPS held out a promise that neither efficiency improvement will be mopped up nor additional investment made for such improvements would be recognised. However, this assurance was not honoured and energy improvements were mopped up four times after 2003 without recognising the corresponding investment. Energy consumption norms have been reduced successively in 2004, 2006, 2015 and 2018. This has been a serious departure not only from notified policy, but also from the principles of equity and normative pricing.
- 3.1.4 Non-updating of fixed cost of urea units: The year 2002-03 was the costed year for Stage-III of NPS policy implemented from October 2006. Fixed cost has not been revised after that. Elements of fixed cost have increased significantly since 2002-03. The government published cost inflation index shows that costs have more than doubled since 2003. But, Indian urea units continue to be reimbursed fixed cost at the level of 2002-03.
- 3.1.5 Pending payments of increase in fixed cost under Modified NPS-III Policy of 2014: With much debate and scrutiny, government notified a nominal increase in fixed cost of Rs. 350/MT urea in 2014 with minimum fixed cost of Rs. 2300 per tonne. It also approved a special allowance of Rs. 150 per tonne to gas based units more than 30 years old. Government has not honoured its own notified policy and steadfastly refused to pay the said amount. This has accumulated to Rs. 4000 crore for the urea sector.

3.2 Phosphatic and Potassic (P&K) Fertilizer sector

- 3.2.1 Industry has been representing that given the importance of fertilizers and heavy subsidy provided by the government, GST rates both on finished products and raw materials should be kept at minimum. Government at the last moment reduced GST on finished products from 12% to 5%. After several representations, it also reduced GST on phosphoric acid, a major input for P&K fertilizers from 18% to 5% in two stages. Government also kept subsidy amount out of GST. But, GST on ammonia and sulphuric acid continues to be 18%. High GST on inputs and low GST on finished products, and that too at subsidised values, result in huge accumulation of input tax credit. This increases working capital requirement.
- 3.2.2 Further, customs duty of 5% each on phosphoric acid and ammonia and 2.5% each on rock phosphate and sulphur compared to 5% duty on finished products is rendering domestic manufacturing uncompetitive compared to imports. The rate of subsidy on domestic and imported P&K fertilizers is same under NBS policy.

4 Delayed payment

- 4.1 Inordinate delay in payment of subsidy increases the working capital requirement and interest cost of the industry. Such costs are not recognised under pricing policy. The payment position has improved to some extent under DBT. But, large amount of previous years' backlogs are still pending. Based on data received from 23 fertilizer companies, total outstanding as on 1st November, 2018 is Rs. 22,638 crore. This amount is likely to increase further in the coming months as subsidy bills for subsequent months fall due and budget allocation gets exhausted.

5 Inadequate budget allocation

- 5.1 Budget allocation of Rs.70,000 crore for 2018-19 is inadequate in view of pending payment situation as on 1st November, 2018 and likely increase in subsidy requirement during the current year due to overall cost push. Increase in gas cost for urea by about 34% and increase in subsidy rates for P&K fertilizers would result in additional subsidy requirement of about Rs.14,000 crores this year compared to 2017-18. The DBT Scheme will become dysfunctional, if enough funds are not available for weekly payment of subsidy bills.

6 Direct Benefit Transfer (DBT)

6.1 The present model of DBT implemented in fertilizer sector is not true DBT, as subsidy is not directly paid to the farmers. Subsidy continues to be routed through the industry. Earlier, the subsidy payment was linked to the material received in the district. But, under DBT, payment of subsidy is linked to sale of fertilizers through POS machine. This has increased the duration of payment cycle of subsidy by 3 to 6 months. This has increased the working capital and interest thereon for the industry. Moreover, problems of hardware, software and connectivity continue to affect generation of subsidy bills under DBT.

7 Impact on Soil Health & Crop Productivity: Imbalanced use of Fertilizers

7.1 Under present subsidy policy, price ratio of DAP vis-à-vis urea has increased from the level of 2:1 in 2010 to 5:1 at present. Price ratio of MOP vis-à-vis urea has also widened from the level of 0.9:1 to 3:1. This is suppressing consumption of P&K fertilizers. Current consumption is heavily skewed in favour of urea. The NPK use ratio has widened from the optimum level of 4:2:1 to 6.1:2.5:1 at present. Such imbalance in use of major nutrients along with inadequate application of secondary and micronutrients are resulting in sub-optimal crop productivity. It may be underlined that our crop productivity is much below the levels of many of our neighbouring countries. Thus, Indian farmers are not getting optimum return from use of fertilizers and other inputs.

8 Impact on the industry

8.1 The impact of all the above policies and procedures is reflected in performance of industry. As per data received from 25 urea units, Indian urea industry as a whole, incurred a negative return on net worth of 0.73% during 2016-17. It is estimated at minus 4.71% for 2017-18 against the benchmark of 12% post tax return.

8.2 P&K fertilizer sector is also not doing well due to unfair taxation regime. Capacity utilisation level of P&K fertilizer segment has declined over the years from 100% in 1997-98 to 67% in 2017-18. Operation at such low level is severely impacting margins of this segment of the industry.

9 Measures to Restore Health & Growth of Indian Fertiliser Sector

9.1 Urea Sector: Restoring health of domestic urea sector needs three-pronged strategy. These are immediate measures, medium term measures and long-term strategies.

9.1.1 Immediate measures

9.1.1.1 Payments of increased fixed cost as per Modified NPS-III Policy from 2014-15 onwards be made without further delay to provide some relief to the industry.

9.1.1.2 Increase in fixed cost beyond Modified NPS-III policy be linked to appropriate cost indices to simplify the policy and avoid delay in updating of cost.

9.1.1.3 Distorted ratio between retail prices of urea and other P & K fertilizers needs correction in the interest of soil health, balance fertilization and crop productivity.

9.1.2 Medium term measures

9.1.2.1 Urea be brought under NBS policy. Gas pooling and rationalisation of energy norms have reduced the heterogeneity among gas based units to a large extent. With existing cost and energy consumption levels, NBS policy can now be implemented for gas based urea plants.

9.1.2.2 Present energy consumption norms be extended for 5 years.

9.1.2.3 Any further revision in energy norms should not be considered in isolation. It should be accompanied with holistic review of the entire policy, including techno-economic feasibility of energy saving measures.

9.1.3 Long term Measures

9.1.3.1 Urea sector be deregulated within a definite time-frame and subsidy be paid directly in the bank accounts of farmers.

9.2 P & K Fertilisers

9.2.1 Withdrawal/reduction of customs duty on phosphoric acid, ammonia, rock phosphate and sulphur and reduction in GST rate on ammonia and sulphuric acid will improve competitiveness of domestic P & K fertilizers vis-à-vis imports.

9.2.2 Correcting distorted price ratio of P&K fertilizers vis-à-vis urea is essential for promoting balanced fertilization and restoring soil health.

9.3 Budget Allocation

9.3.1 Additional budget allocation of Rs.30,000 crore is needed to ensure timely payment of subsidy on weekly basis, as assured under DBT model. This amount should help to clear backlog of the previous years to a large extent. Continued weekly payments under DBT are incumbent upon adequate budget allocation.

9.4 DBT

9.4.1 Besides addressing existing snags in DBT system which are delaying bill generation, government needs to set a definite timeframe for payment of subsidy directly to the farmers' bank accounts.

9.4.2 But, till the payment of subsidy is routed through the industry, government must ensure weekly payments to the industry and recognise increase in working capital requirement and interest cost arising due to implementation of present model of DBT.

10 Conclusion

10.1 The industry is prepared for decontrol. But, till government continues to regulate production, distribution and prices of fertilizers, it must ensure recognition and payment of legitimate costs of industry in time. Fertilizer prices and subsidy policies need drastic reforms based on established economic principles of normative pricing. This should ultimately lead to ease of doing business under broad regulations.

10.2 The notified policies approved by the government be implemented. Vibrant domestic fertilizer industry is in the interest of Indian agriculture and the country as a whole.

11 FAI Annual Seminar 2018

11.1 In light of the above, the FAI Annual Seminar this year has been devoted to the theme 'Making Fertilizer Industry Viable and Vibrant'.

11.2 You are all cordially invited to participate in the entire 3-day event including inaugural function on 5th December 2018 followed by technical sessions during the next two days and valedictory session on 7th December, 2018. In all, 15 papers will be presented in the technical sessions on 6th and 7th December, 2018. In addition, this year's Seminar will have a Panel Discussion on 'Fertilizer Policies – Need for Change'. Panellists include renowned economists, policy makers and industry leaders. The Seminar will be attended by more than 1200 delegates, including about 150 foreign delegates, representing fertilizer industry, research organisations, agricultural universities, global think tanks and concerned ministries/departments of Central and state governments.

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