Frank Notes

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Liquidity Crisis Persists for Fertilizer Industry

Indian fertilizer industry continues to operate under an archaic regulatory environment. Production, distribution, sale and retail prices; all are regulated by the government either directly or indirectly. Policies framed in 1970s were relevant at that time to encourage fertilizer consumption and build indigenous capabilities for production and supply of fertilizers. However, continuing with same policies with same controls and restrictions has lost relevance today. It has become one of the most difficult sectors to do business. Policies are also giving rise to imprudent use of farm nutrients, thus hurting soil health and agriculture productivity. Needless to say that it is also not helping in increasing farm income.

Industry has been advocating for policy reforms for last two decades. But, changes in policies have been very few and have not changed the basic policy framework for the sector. Industry is suffering on several counts, *viz*., difficulty of doing business under stifling controls, under recovery of costs under present policy parameters and lastly undue delay in settlement of huge subsidy bills.

Due to almost stagnant retail price of urea and cost push in production, the level of subsidy has been increasing over the years. At present, subsidy accounts for 75% of cost of urea production. It means, industry has to collect 75% of sale revenue from the government. Delay in payment of such huge subsidy dues has increased the requirement of working capital manifold in last 15 years. Ironically, such additional working capital requirement and interest costs are not recognised and reimbursed under the pricing and subsidy policy for urea, severely impacting the bottom lines of the industry.

Delay in disbursement of subsidy is primarily due to inadequate allocations for fertilizer subsidy year after year in the Union Budget. Apart from the budget constraints, timely payment of subsidy also gets held up due to various procedural delays. There is always delay in approval and notification of revised subsidy and freight rates and updation of software of Integrated Fertilizer Management System (iFMS). Delay in notification and uploading of updated subsidy and freight rates hold up the preparation and submission of subsidy bills. For example, increase in cost of natural gas should be recognised and paid on quarterly basis, but it remains to be updated for several quarters. The amount on this account is huge due to increase in gas cost of more than 30% in last 18 months. This is of serious concern because unless the bills are generated and submitted, it does not reflect in the subsidy receivables. Such held-up subsidy payments are never shown as outstanding dues and hence requirement of additional allocation.

The experience of past several years shows that a significant amount of subsidy dues remain outstanding for which bills could not be generated and submitted within prescribed time due to various reasons as explained above. For instance, out of Rs.30,112 crore outstanding subsidy dues as on 1st November, 2017 as per industry data, almost 59% was pending for which fertilizer companies could not submit their bills. The balance 42% subsidy dues were pending against the bills already submitted. Further, out of current estimated total outstanding subsidy dues of Rs.30,000 crore, 58% is pending for which bills have already been submitted and the balance 42% is pending for which industry is not able to submit their bills for various reasons.

Indian fertilizer industry is performing onerous task reaching the subsidy to about 146 million farming families, and that too, without any cost to the government. But due to delay in payments, industry is forced to bear the additional interest cost of about Rs.2000 crore per annum. Industry in fact is working as financer to the government. Carry forward of unpaid subsidy bills of one year to the next year helps the government defer its liability. Indian fertilizer industry instead of being

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rewarded for doing the daunting task of reaching subsidy to millions of farmers is being penalised.

Direct Benefit Transfer (DBT) for fertilizer subsidy has been implemented since March 2018. But, under the present model of DBT for fertilizer sector, payment of subsidy continues to be routed through the industry. It has only changed the mode of payment of subsidy to the industry. Earlier, subsidy on fertilizers used to be released when the material reached the district. But, under DBT, fertilizer subsidy becomes due to industry only after sale of fertilizers to the farmers through Point of Sales (POS) Machine. This has postponed the payment of subsidy by about six months. This is because production of fertilizers is continuous during the year but, sales of fertilizers are seasonal. In fact, fertilizers are sold mainly during peak season of 1-1.5 months each in k*harif* and r*abi* seasons. During rest of the months, fertilizers have to be manufactured, moved and stored near consumption points. This means, DBT has further increased the requirement of working capital equivalent to production and distribution cost of 6 months. The net impact of all the factors is that interest cost of urea has increased by more than Rs. 400 per tonne.

Industry has been raising this issue right from the beginning when DBT scheme was being conceived. Industry was assured of clearing all past dues before implementation of DBT. Further, DBT system provided for weekly payment of subsidy instead of monthly payments earlier. These two steps were expected to ease the payment process. Inspite of numerous problems, industry made all out efforts to implement the scheme. But, government has not fulfilled its obligation of clearing past dues and making payment on weekly basis. The payment situation remains far from satisfactory. Out of total outstanding dues of Rs. 30,000 crore, 48% belong to pre-DBT era and the balance 52% belong to DBT period. As mentioned earlier, payments are stuck both due to budget constraints and procedural matters.

There are other pending dues on account of differential freight which have been pending since 2008-09, revision in primary and secondary road freight for urea pending for 2017-18 and 2018-19, revision in primary road freight for P & K fertilizers pending from 2013 onwards and revision in special freight compensation for movement of P & K fertilizers in difficult areas pending since 2012 onwards. It is needless to mention that fertilizer companies have to make immediate payment for raw materials, natural gas and other inputs and services. During the current year also, the payment of subsidy is held up from the month of December 2018 onwards for most of the companies due to budget constraints and the same can be resumed only by April, 2019 after release of funds from the next year's budget (2019-20). In the meantime, loan of Rs. 10,000 crores has been arranged under Special Banking Arrangements (SBA) to tide over the liquidity crisis but companies are yet to realise the payment under this arrangement. The repayment of this loan alongwith interest will be made out of next year's budget allocation. Thus, it has not increased the overall availability of funds for fertilizer subsidy.

It is high time government addresses the issue of pending subsidy dues. As a first step, there should be allocation of adequate funds for fertilizer subsidy in the Union Budget based on realistic estimates as per notified policies. The government should liquidate all the past liabilities by making one-time allocation and then ensure timely payment of subsidy through adequate annual allocations. The policies and procedures also need simplification. If the delay in payments is unavoidable, there should be a provision for interest on dues pending beyond a prescribed time. Further, banks should allow borrowing to finance pending subsidy payments upto 6 months instead of provision of 60 days under present guidelines of the RBI. There is a need for making provision of working capital requirement of six months in urea pricing policy to address the prolongation of payment cycle under DBT. Any loss of production due to liquidity problem may not only give rise to some non-performing assets (NPA) but will also result in higher imports. These positive steps are necessary to ease the liquidity problem and sustenance of operation.■