

## Imports must be a vital part of any fertiliser strategy

Huge subsidies are hurting both the soil and farm profits. Use cheaper imports, give subsidies in cash to farmers

**ALL SUBSIDIES ARE** justified as either helping producers or users, but in the case of urea fertilisers, neither seem to be benefiting, as a paper by Icrier’s Ashok Gulati and Pritha Banerjee shows. So, while it is true that around 77% of the cost of urea is subsidised, a large part of this goes to local producers: right now, Indian prices are around \$332 per tonne for urea versus global prices of \$285 (cif), and the latter were a fourth lower than this a couple of years ago. Just seven Indian plants are cost-effective right now, compared to 17 in FY15. And, with the government not accounting for the hike in industry costs for a long time, industry’s PAT-to-Net-Worth has been negative for the last five years; it has been positive for four years if you include some of the promises made in the last price policy, but at an average of 3.3%, this is far below the 12% the industry was assured. Also, a cash-strapped government still owes the industry around ₹39,000 crore.

Apart from the fact that a large part of the ₹50,000 crore urea subsidy goes to local producers, discerning farmers would prefer this be converted into a less distortionary cash-transfer. Right now, since urea (N, to use the chemical term) costs a fraction of what it should, farmers use too much of it; against the ideal N:P:K ratio of 4:2:1, the average is 6.1:2.5:1, and this goes to as high as 25.8:5.8:1 in states like Punjab. This has resulted in a sharp fall in productivity due to the nutrient balance in the soil worsening. While farmers got 13.4 kg of grain for each kg of fertiliser used in 1970, this fell to just 3.7 kg in 2005; it is even lower today. With farmer yields falling, so are profits; if farm incomes are to be doubled by FY23, fixing the nutrient imbalance is critical. If farmers got the same amount of subsidy anyway, they would buy less of urea if its price were raised to market levels; this would, over time, result in higher yields.

Since Indian producers are, on average, more energy efficient than global ones, the price of natural gas is what determines the difference in the costs of urea; till urea plants got more of the cheaper local gas, their costs were more reasonable. In FY13, 76% of the gas used was local; it was 30% in FY20. With gas costs rising from \$9.8 per mmBtu in FY16 to \$12.3 in FY17, Indian costs have surged. The industry’s poor financials, in turn, have limited fresh investment. While that is the reason why the government is trying to revive five shut units at a cost of ₹39,651 crore, it makes little sense since the average cost of these plants will be \$450-550 per tonne. Ideally, India should be importing urea, possibly from plants set up in the Gulf, or in Russia, by Indian firms, or enter into long-term contracts with them; in years when global prices shoot up, India can possibly export urea. Moreover, if the government were to encourage more local production of gas and not insist that more of it be sold to power plants—a lower gas price for power plants lowers the power subsidy while increasing the fertiliser one—local production costs of urea could also fall.

A related issue is the high social and environmental cost of the policy. Gulati and Banerjee discuss the impact of excess nitrogen from urea leaching into the soil, and that of the deficiency of, for instance, sulphur, iron, zinc, and manganese caused by use of too little non-urea fertilisers; this, the authors posit, is responsible for stunting and, due to nitrate contamination of water, even blue babies.

## Security vs privacy

National security is paramount, but privacy concerns real

**IF THE WHATSAPP**-Pegasus controversy wasn’t bad enough, Google’s report on 500 Indian citizens—out of a total of 12,000 worldwide—being the victims of attacks by government-backed bodies has, once again, brought the issue of government spying to the forefront. While the government has continued to sidestep the issue of whether it had bought the Pegasus software that was used to exploit a WhatsApp loophole to hack into the phones of various activists, the matter continues to be debated in Parliament and a parliamentary panel will try and get more clarity on the issue; for the record, the government has sent a notice to the Israeli firm to get more data on who bought the snooping software. Pegasus set the cat among the pigeons when it said it only sold its software to governments; assuming this is true, though, it could still have been available on the dark net. And, even Google’s data from its Threat Analysis Group—TAG tracks more than 270 targeted or government-backed groups from more than 50 countries—may not be wholly accurate. While it finds that the Indian government-backed bodies were intercepting a smaller proportion of Indian citizens than was happening in the US by US-govt-backed hackers—these are attacks on Google Drive, Gmail, and YouTube—the data looks a bit lopsided since it shows that there is less interception by governments in countries like China and Russia! Indeed, in the past, Apple challenged Google over its analysis concerning the monitoring of iPhones.

That said, there is a more fundamental problem that needs resolving—that of reconciling the needs of the government in terms of being able to spy on certain people with their right to privacy. As the Justice Srikrishna panel put it, the design of the current framework for tapping/hacking “lacks sufficient legal and procedural safeguards to protect individual civil liberties”. The tapping or hacking by government agencies is, right now, authorised by the Telegraph Act as well as the IT Act, but as Srikrishna pointed out, there aren’t enough safeguards at the moment. There is, of course, an oversight mechanism within the government; the review committee is headed by the cabinet secretary and has the law secretary as a member, but as Srikrishna says, citing a recent RTI reply, the “review committee has an unrealistic task of reviewing 15,000-18,000 interception orders in every meeting, while meeting once in two months”; in other words, no matter what the government might say, the review process looks less than robust.

It is in this context that the *Puttaswamy* judgment of 2012 is critical. The judgment talked of all such interceptions meeting the tests of “necessity, proportionality and due process”. If a committee is clearing 15,000 interception orders, it is difficult to argue ‘due process’ is being followed. That is why, as Srikrishna suggests, India needs a law on interception that builds in checks like having a non-partisan committee examining the intercepts, why they were ordered, and what they revealed. Such a process could involve a permanent parliamentary committee, with the data/findings not to be made public; another could involve a judicial committee or judicial members on this committee as well. If, for instance, those whose phones were hacked using the Pegasus software were unfairly targeted—say, by a government trying to be vengeful—there has to be some mechanism to punish those responsible.

## HealthSPEND

State-sponsored insurance may not be the best idea. Instead, govt should increase spend on offerings

**A NEW PAPER** by researchers at the National Institute of Public Finance and Policy shows that basic healthcare will suffer after implementation of large government-sponsored health insurance schemes like Ayushman Bharat, especially when the government must contend with a fiscal strain. The researchers examined health insurance schemes implemented by the governments of undivided Andhra Pradesh, Karnataka, and Tamil Nadu between 2004-2017. In all three states, the schemes started with covering just the poor, and were gradually extended to other sections of society. Insurance spending cast a shadow on other public health spending, including on primary and secondary healthcare—this increases dependence on private healthcare, which, in turn, pushes up the costs of insurance schemes. The Centre, which is mulling over insurance-based universal healthcare coverage, should take note.

The government must vastly expand its healthcare spend; public spend on healthcare is just 1.13% of the GDP while the total spend is around 4%, indicating, against a backdrop poor health insurance penetration (total health insurance premium, including government, private, and standalone insurance, stood at just ₹37,000 crore in FY18), massive out-of-pocket expenditure. But, as the NIPFP study shows, public-funded health insurance schemes may not be the best idea, more so, given the high chances of fraud as Rajasthan’s Bhamashah experience shows. Instead, the government must increase healthcare offerings, from infrastructure to direct spending—Delhi offers a template, having made diagnostics and surgery free at private hospitals (the government will pay the hospitals), it is now making ICU beds free, all subject to referral by a government hospital.

## ● RCEP PULLOUT

WHILE FTAs CAN OPEN LARGE MARKETS FOR INDIA AND DRIVE EXPORTS GROWTH, WITHOUT POLICIES TO IMPROVE COST OF DOING BUSINESS, IT CAN SERIOUSLY HARM DOMESTIC ECONOMY

# Innovation & productivity key to benefiting from FTAs

**TRADE IS THE** life-blood of the world economy. We all know that. The share of global trade grew from around 10% of global GDP

to close to 60% by the 2010s. And, those countries which grew their share of the global trade benefited from the huge multiplier effect on their economy. Given this context, India’s decision to withdraw from RCEP, designed to be the world’s largest trading bloc, was a landmark decision, notwithstanding official comments that we will rejoin if our concerns are addressed. This decision has both passionate supporters and sceptics; the former group agrees with the government’s ‘strong’ decision based on the rationale that the conditions being negotiated for joining RCEP would have been detrimental for Indian industry. The opposite logic put forth is that by withdrawing, we would actually be disadvantaging Indian industry in terms of preferential access to the largest and the fastest growing markets. So, who is right?

To answer this question, let us look at the data from past FTAs and their impact on competitive positioning of Indian industry in global trade. In the last decade and a half, India has signed three regional FTAs—with South Asian, ASEAN, and Mercosur (the trading bloc of Latin American) countries. The other FTAs have been bilateral agreements with individual countries. Of the three regional FTAs, in only the South Asian FTA (Afghanistan, Bangladesh, Bhutan, India, Nepal, Sri Lanka, Pakistan, and Maldives) did India increase its exports faster than imports; this is understandable given the member countries. In case of both, the ASEAN and Mercosur FTAs, India’s trade deficit with these two regions increased post signing. For example, post signing of the India-ASEAN FTA in 2010, trade between India and ASEAN increased from \$52.6 billion to \$64.6 billion in 2016. How-



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ever, ASEAN countries benefited more, with India’s trade deficit increasing from less than \$8 billion in 2009-10 to about \$22 billion in 2018-19. Similarly, post signing of the India-Mercosur FTA in 2009, India’s exports grew from \$2.31 billion in 2009 to \$3.14 billion in 2016, but its imports grew faster, from \$5.34 billion to \$11.46 billion in the same period. This data, thus, supports the government’s view that RCEP will be harmful to India’s interests unless carefully calibrated and negotiated.

Now, let us look at data supporting the logic of the critics of the RCEP pull-out, who claim that this will disadvantage Indian exporters by denying them preferential access to large markets. Let us use the example of apparel exports, which has been a focus industry for Indian policymakers for many years given the potential of its high labour intensity to generate millions of new jobs. While India’s share of global apparel trade has stagnated around 4%, that of competing countries like Bangladesh, and even Vietnam, which entered the global market much later, has leapfrogged ahead of India’s. This, despite the potential advantages India has in terms of higher scale from larger local market, domestic supply of cotton and synthetic yarn, and large pool of labour. In a BCG study of India’s competitive position in the sector, we found that Indian exporters face a cost disadvantage of 14-15% for exports into the EU, compared to Bangladesh. What is interesting to note is that over 60% of this gap is explained by preferential access to the EU market basis Bangladesh’s FTA with



the EU (India has not signed one). The balance cost gap is driven by a variety of domestic structural, regulatory/policy, and productivity factors. For example, the scale of an average Indian clothing plant is much smaller than that in Bangladesh due to our restrictive labour laws (to be fair to the NDA government, they have tried to partially address the labour issue for the textile industry, but much more needs to be done); this gives a cost penalty to the average Indian apparel exporter. India has tried to incentivise exports to overcome some of these structural gaps with several export promotion schemes, but the recent ruling by WTO against India on a complaint by the US has put the future of many of these incentives in doubt.

So, basis the data, the views on both joining and quitting RCEP have a strong rationale. And, one can argue that the government took a pragmatic decision as it did not want a similar increasing-deficit story repeated with the new regional treaty, especially given the fear of being swamped by exports from China. Unfortunately, this decision also highlights the lack of global competitiveness in many sectors of Indian industry—even with smaller developing countries, given the experience post ASEAN and Mercosur FTAs.

India has rightly been focusing on ease of doing business (EoDB) as critical

to build competitiveness and attract FDI. It is equally critical, if not more so, to focus and improve the high cost of doing business (CoDB), which broadly has three components: higher factor costs (land, industrial power, productivity-linked labour, financing), higher cost of compliance with government regulations, and high logistics costs from both hard and soft infrastructure (e.g., time taken by processes at ports). And, unless we annually benchmark and improve the CoDB as we are doing for EoDB, our manufacturing industry, especially compared to our peer developing countries, will continue to be threatened by FTAs rather than seeing them as windows of opportunities.

Clearly, FTAs are a double-edged policy sword for India. If wielded right, it can open large markets and drive growth of exports (and push up GDP). It also puts pressure on the domestic industry to become more globally competitive. If wielded badly, i.e., without the policies to improve CoDB, it can be equally harmful to the domestic economy. Countries that have done it right have ensured that their trade policy, investment

policy, and industrial policy are well-aligned. They calibrate the opening of the domestic market with the right industrial and investment policies to structurally improve the competitiveness of the domestic industry. The industry, in its turn, has to match these enabling policies with a strong effort to improve productivity, and invest in innovation to increase global competitiveness, rather than complaining of cheaper imports flooding the country. Otherwise, we will continue to be ambivalent about FTAs, and struggle to become the next highly competitive manufacturing engine of the world.

**Countries that got FTAs right calibrated the opening of the domestic market with the right the policies to improve competitiveness of domestic industry**

## After the US-China trade war

The politics of the trade war now point more toward de-escalation than a renewed ratcheting up of tensions

**FOR THE LAST** two years, the conflict between the US and China has dominated the economic and financial-market debate—with good reason. After threats and accusations that long predate the US president Donald Trump’s election, rhetoric has given way to action. Over the past 17 months, the world’s two largest economies have become embroiled in the most serious tariff war since the early 1930s. And the weaponisation of US trade policy to target perceived company-specific threats such as Huawei has broadened the front in this battle.

I am as guilty as anyone of fixating on every twist and turn of this epic struggle between the world’s two economic heavyweights. From the start, it has been a political conflict fought with economic weapons, and is likely to remain so for the foreseeable future. What that means, of course, is that the economic and financial-market outlook basically hinges on the political dynamic between the US and China.

In that vein, the so-called phase one “skinny” trade deal announced with great fanfare on October 11 may be an important political signal. While the deal, if ever consummated, will have next to no material economic impact, it provides a strong hint that Trump has finally had enough of this trade war. Consumed by domestic political concerns—especially impeachment and the looming 2020 election—it is in Trump’s interest to declare victory and attempt to capitalise on it to counter his problems at home.

China, for its part, would also like nothing more than to end the trade war. Politics is obviously very different in a one-party state, but the Chinese leadership is not about to capitulate on its core principles of sovereignty and its aspirational mid-century goals of rejuvenation, growth, and development. At the same time, there can be no mistaking downward pressures on the economy. But, with Chinese policymakers determined to stay the course of their

three-year deleveraging campaign—an important self-inflicted source of the current slowdown—they should be all the more eager to address the trade-related pressures brought about by the conflict with the US.

Consequently, the political calculus of both countries is coming into closer alignment, with each looking for some face-saving truce. There is always a risk that other complications will arise—recent events in Hong Kong and revelations of developments in China’s Xinjiang Province come to mind. But, at least for the time being, the politics of the trade war are now pointing more toward de-escalation rather than a renewed ratcheting up of tensions.

If that is the case, and if a phase one accord is reached, it behooves us to ponder what the world will look like after the trade war. Several possibilities are at the top of my list: deglobalisation, decoupling, and trade diversion.

Deglobalisation is unlikely. Like the first wave of globalisation that ended ignominiously between World War I and the Great Depression, the current wave has generated a mounting backlash. Populism is rearing its ugly head around the world, and tensions over income and wealth inequality—aggravated by fears that technological innovations such as artificial intelligence will undermine job security—are dominating the political discourse. Yet the climactic event that underscored the demise of the first wave of globalisation was a 60% collapse in world trade in the early 1930s. Notwithstanding the current political dysfunction, the odds of a similar outcome today are extremely low.

Global decoupling is also unlikely. Reflecting the explosive growth in global value chains (GVCs) over the past 25 years, the world is woven together more tightly than ever before. That has transformed global competition away from the country-specific paradigm of the past to a far more fragmented competition between widely distributed

platforms of inputs, components, design, and assembly functions. A recent IMF study found that GVCs accounted for fully 73% of the rapid growth in global trade that occurred over the 20-year period from 1993 to 2013. Enabled by irreversible trends of plunging transportation costs and technological breakthroughs in logistics and sourcing, the GVC linkages that have come to underpin global economic integration are at little risk of decoupling.

Trade diversion is another matter altogether. As I have long argued, bilateral trade conflicts—even a bilateral decoupling—can do nothing to resolve multilateral imbalances. Putting pressure on one of many trading partners—precisely what the US is doing when it squeezes China in an effort to reduce its merchandise trade deficits with 102 countries—is likely to backfire. That is because America’s multilateral trade deficit reflects a profound shortfall of domestic saving that will only get worse as the federal budget deficit now veers out of control. Without addressing this chronic saving problem, targeting China will mean pushing the Chinese piece of the multilateral deficit out to America’s other trading partners. Such diversion will shift trade to higher-cost foreign sourcing—the functional equivalent of a tax hike on US consumers.

Trade truce or not, a protracted economic struggle between the US and China has already begun. A cease-fire in the current battle is nothing more than a politically expedient pause in what is likely to be an enduring Cold War-like conflict. That should worry the US, which is devoid of a long-term strategic framework. China is not. That is certainly the message from Sun Tzu in *The Art of War*: “When your strategy is deep and far-reaching... you can win before you even fight”.

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## LETTERS TO THE EDITOR

On electoral bonds

As a nation, we must address ourselves to the concerns expressed by RBI and the Election Commission (EC) over the opaqueness surrounding the electoral bonds. We cannot afford to be indifferent to the issue as it bears on transparency. There were fears of a ‘hidden agenda’ when the government, in 2017, rushed the Bill through the Lok Sabha as a finance bill without proper regard to how it would ensure transparency. Even then RBI and the EC raised serious objections, but the government paid them scant attention and bulldozed the scheme through the Lower House. Now, coincidentally, thanks to the RTI Act, it has come to light that the government violated RBI regulations to enable the party, of which it is principally made of. The charge that the corporates have laundered black money through electoral bonds merits further investigation. As things stand, corporates can influence decision-making and they do. These are not like voluntary donations to charity given out of humanitarian or altruistic instincts. In this sense ‘donation’ is a euphemism or a synonym for ‘bribe’. When electoral bonds are exclusively issued by the state-run SBI, the government cannot feign ignorance of the details and refuse to share them with the people. It is telling that 95% of all funding through electoral bonds went to BJP, and ‘a party with a difference’ to boot. Opposition parties are at a distinct disadvantage because any donation might invite trouble. Nothing short of disclosure of the names of donors and recipients, and the exact sums donated in the public domain alone will meet the people’s right to know how much funds are raised. In a democracy the government should subscribe to the notion of ‘voter sovereignty’, if one may use the phrase and provide or pass on information to those to whom it owes its very existence. — G David Milton, Maruthancode

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**INDIA'S EXPERIENCE WITH** fertilisers, in the later part of the Green Revolution, prompted it to adopt a policy of subsidising fertilisers. In 1977, the country had a total NPK (nitrogenous, phosphatic and potassic) fertiliser consumption of 4.3 million metric tonnes (mmt) and per hectare usage of 24.9 kg—by FY19, total consumption had risen to 27.3 mmt and per hectare usage stood at 137.6 kg. Increased fertiliser usage also meant a concomitant spurt in agricultural production; total foodgrain production reached 284.95 mmt in FY19—an over-three-fold increase from the production in 1977-78. Of course, increased foodgrain production has been a boon for food security, with per capita availability increasing from 155.3 kg in 1976 to 180.3 kg in 2018. Looking at the gains, continuing with the fertiliser policy would not only seem sensible, but also—given foodgrain requirement is going to go up, and the climate crisis impact predicted to be quite severe for India—necessary. However, as a paper by Icrier researchers Ashok Gulati and Pritha Banerjee shows, the challenges rooted in the subsidy policy for the major stakeholders—farmers, industry and the government—are so serious, and the fallout of excessive fertiliser use so severe, that subsidising and producing fertilisers in the country seems a bad proposition.

Thanks to India subsidising primarily urea (N of NPK), there is rampant overuse of urea; imbalance in the consumption of fertilisers has led a worsening of soil quality that has resulted in falling crop response to fertilisers, which, in turn, has caused farm productivity and farmers' profitability to be adversely affected. In 2005, the crop response ratio to fertilisers had fallen to 3.7 kg grains/kg fertiliser, from 13 kg/kg fertiliser in 1970. Ironically, falling productivity, in the face of hugely subsidised urea—urea accounts for 64% of the government's subsidy for fertiliser, with 77% of its price being subsidised—has led to worse overuse, drastically skewing the ideal usage ratio, and altering the soil chemistry further. It is, thus, somewhat of a vicious cycle. Low crop response ratio means lower yields—in 2016, India's average paddy yield per hectare was a good 1 metric tonne lower than the world average. Similarly, India's wheat yield that year was 3,093 kg/hectare, compared with the world average of 3,405 kg/ha. Paddy, maize, cotton, soybean and potato cultivators all experienced losses in FY15, compared with FY13 and FY14. To be sure, there could be other factors at play, too—indeed, since 2014, every year other than 2016 has seen below normal monsoon, with 2014 and 2015 experiencing the worst deficiencies—but the link between fertiliser overuse and the decline in soil productivity is a strong one. With falling farm yields, exacerbated by climate effects, doubling farmers' real income by FY23 will be difficult, which means continuing to subsidise fertiliser will work against the government's stated goal for the agriculture sector.

Fertiliser policy has left the industry, too, fighting many problems. While subsidy and controls meant fertiliser production boomed in the country, over the past two decades these policies have hobbled the industry. With no proper incentives, domestic urea production rose just 4.4 mmt between 2000-01 and 2018-19, even as consumption was



## INDIA'S FERTILISER DRAIN

# Urea of darkness

A study by Icrier researchers Ashok Gulati and Pritha Banerjee shows how problematic the fertiliser policy is—for farmers, industry, the environment and the government. The need is to urgently end subsidies and switch to direct cash transfers to farmers, while paring down production and relying on less expensive imports

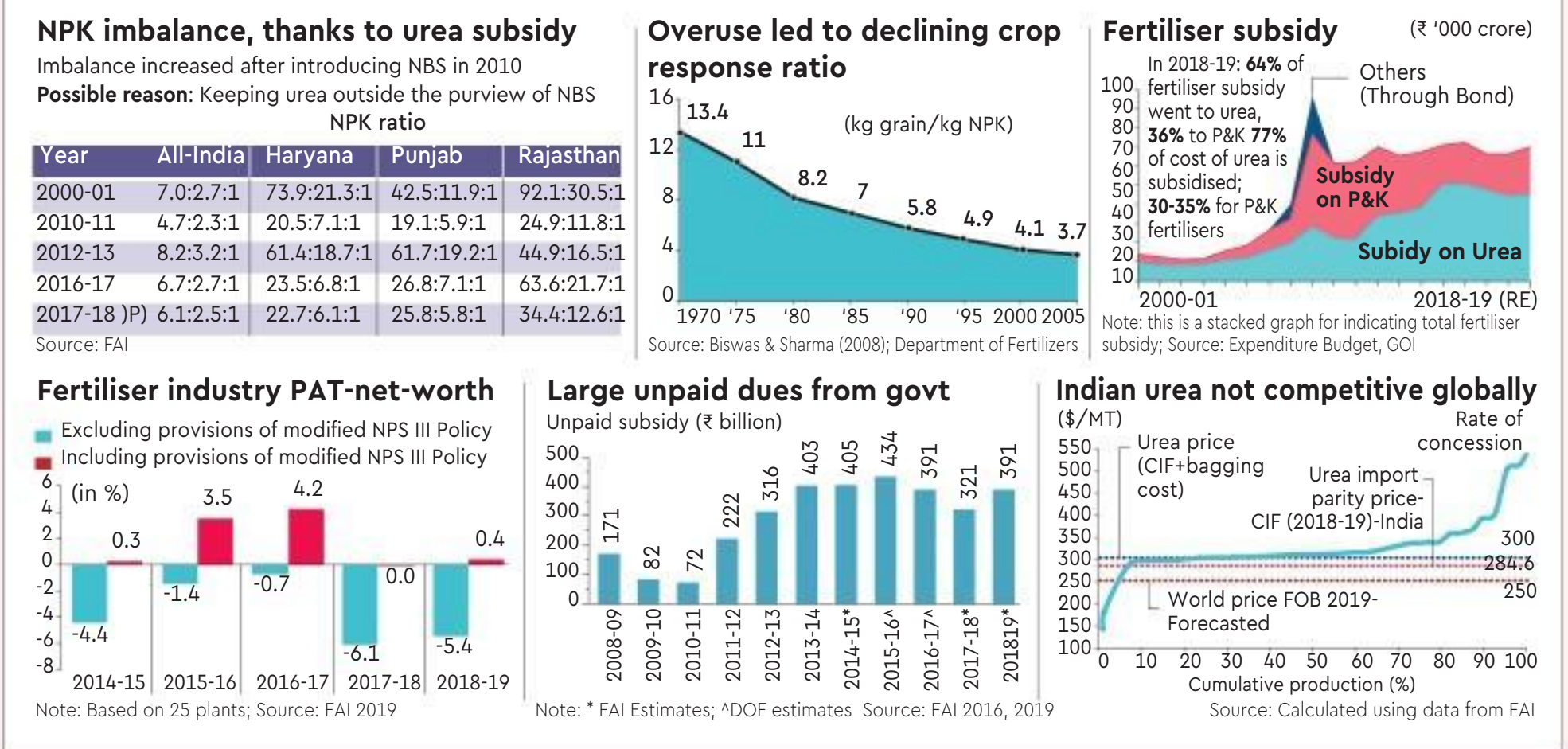
12.8 mmt. Given urea production stood at 23.9 mmt while consumption was at 32 mmt in 2018-19, India, thus, is a major urea importer. Of the 30 urea production plants in the country, 27 use natural gas and three use naptha as the feedstock. The average cost of production for all domestic urea capacity stands at \$332.2/metric tonne. Given the global urea price stood at \$284.6/metric tonne (CIF) in 2018-19—bagging and handling charges took this to \$300/metric tonne—domestic urea production is simply uncompetitive. Only seven of the 30 Indian plants were operating below the global price (CIF + bagging and handling). In 2014-15, when the global price was \$287/metric tonne, 17 Indian plants were operating at costs below \$300/metric tonne. This means, over the last four years, the cost of production has increased significantly for Indian urea production.

While the best of Indians match their global peers in terms of energy

efficiency, the average Indian plant has a better showing than the world average. So, where is the problem? It is the cost of the feedstock. In 2015, the government introduced pooling of natural

gas so that all fertiliser plants got gas at the same price. While the price of domestic gas is still low, the price of the pooled natural gas for the fertiliser industry has shot up from \$9.8/mmBtu

on net calorific value in FY16 to \$12.3/mmBtu. This is because the share of low-priced domestic gas in the total gas consumed by the industry has declined from 62% in 2014-15 to 38%



in FY19, and is estimated to have slipped to 30% in Q1FY20. Part of the fall is because the share of supply of locally-produced gas to the power sector and other users has increased sharply. Gas-pricing (factor of supply, among other things) that is still regulated by the government—though, in November, there were reports that the government is mulling over lifting all control—is just one reason. The fixed costs of the urea industry have been kept constant in nominal terms since 2002-03. While several committees have recommended a review and even the Cabinet has passed a decision to pay ₹350/metric tonne as interim relief—the industry estimates the increase in fixed costs to be much higher than this amount—nothing has been paid. This is on top of the unpaid subsidies of just over ₹39,000 crore to the industry (up from ₹17,000 crore in 2008-09). Thus, it doesn't come as a surprise that the industry's PAT-to-Net-Worth has been in the negative over the last five years; it has been in the positive in the last four years if the provisions of New Pricing Scheme-III are considered, but, even then, this averages 3.3%, much below the 12% promised.

Between FY01 and FY19, urea subsidy has increased from ₹9,500 crore to ₹45,000 crore, and as per FY20 Budget estimates it will be ₹50,000 crore. With the sharply increased share of urea subsidy in the total fertiliser subsidy—and the fact that nearly 77% of the cost of domestic urea production is subsidised, while for P&K fertilisers it was just 30-35%—there is rampant overuse of urea as the difference in prices of urea and P&K fertilisers is now quite large. Over time, the phosphatic and potassic content of the soil is affected greatly even as nitrogenous content is thrown off balance. The indicated N:P:K usage for Indian soil is 4:2:1. While it stood at 7:2:7:1 in 2000-01, it was still askew at 6:1:2.5:1 in 2017-18, while in Punjab and Haryana, two of India's top agrarian states, the ratio was 25.8:5.8:1 and 22.7:6.1:1, respectively.

Given Indian soils have relatively low nitrogen use efficiency (average of 22% estimated in 2008), the bulk of the urea applied contaminates ground- and surface water and the atmosphere. So, the current fertiliser policy is subsidising pollution. The bulk of the applied urea is lost as ammonia (NH3), dinitrogen (N2) and NOx (nitrogen oxides)—while the ammonia gets converted to nitrates, increasing soil acidity, NOx gases are major air pollutants. Nitrate contamination of groundwater, which leads to conditions such as methaemoglobinemia (commonly known as blue baby syndrome), has reached far beyond WHO safe limit in Punjab, Haryana and Rajasthan.

Given how uncompetitive local production of urea, and how distortionary the effect of the subsidy policy is, it makes a lot of sense for India to junk domestic production and import urea from, say, a Gulf nation where natural gas is abundant and thus costs of production are low, and, instead of subsidising fertilisers, make direct cash transfers to farmers. With fixed amounts, farmers will likely temper their usage of fertilisers in the interest of soil health as prices of fertilisers will be decontrolled. Instead, the government seems keen on shoring up domestic production—even if the costs are uncompetitive—having announced a plan to rejuvenate five plants, at an investment of ₹39,651 crore. This not only goes against the Prime Minister's call to halve urea consumption by 2022, but will also make domestic urea even more uncompetitive as the fixed costs will be higher for the rejuvenated plants. The government needs to get sensible, else the health of the soil, citizens (including farmers) and the industry will suffer greatly.

## OVER THE BARREL

**ACHANT HEARD IN** every boardroom and management discussion is “Good governance”. The phrase has not been precisely defined. It is variously interpreted, but common to all interpretations is the understanding it means transparent, fair and ethical corporate behaviour; the full and accurate disclosure of financial and operational information and the adherence in the letter and spirit to the law. People start arguing when the somewhat nebulous concept of “social responsibility” is added to the chant. It then befalls upon corporate management to define this phrase and to find a pathway that balances the demands of the shareholders for maximal dividends and capital appreciation with the pressures to contribute to societal welfare. The search for this pathway is what has prompted this article.

The benefits of “good governance”, however imprecisely defined, have been quantifiably established. The NGO Reputation Institute estimates that intangibles like reputation make up approximately 81% of a company's value and that a “strong reputation yields 2.5 times better stock market performance” compared to the overall market. One could debate the methodologies behind these calculations, but the central message is indubitable. Well-governed companies have easier access to capital; they pay lower interest rates; they secure better credit terms; and they attract the best and brightest of talent. Good governance is good business.

The message is further reinforced by the anecdotal evidence of the prohibitive costs of “poor governance”. The whistle-

# Good governance is good business

The Gilgamesh solution to good governance and corporate India

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blower allegation of a breach in the disclosure of financial data by the management of Infosys is a case in point. The market cap of the company dropped by approximately Rs 50,000 crore in one trading session. The twists and turns of the IPO of the Saudi government owned oil and gas company Aramco is another example. The Saudis had valued their company at around \$2 trillion. Their financial advisers, however, came back after testing the market with a valuation of \$1-1.2 trillion. They told the Saudis that the discount was, inter alia, because of perceptions of opacity in the Saudi governance structure. The Crown Prince of Saudi was not pleased and decided to pull back the IPO from the European and US markets.

Few question the business case for good governance. But many wonder how, in fact, it can be delivered. How, it is asked, can management be motivated to balance the interests of the shareholder with that

of the society when the incentive structure is skewed disproportionately in favour of short-term financial performance. The chant of “good governance” is fundamentally hypocritical, it is suggested. And will remain so until a process is engendered to create a balanced incentive structure that motivates the generation of financial returns through societal welfare than the current structure that regards one as a trade-off for the other.

There is no one-size-fits-all response to this conundrum, but a tale from 6,000 years ago may offer guideposts for stakeholders of governance to initiate such a process.

Gilgamesh was the King of the Sumerian town of Uruk. He was a courageous leader and a builder. He had created, by all accounts, a remarkable city with wide boulevards, open spaces and excellent public facilities. He was, however, an unabashed tyrant. No one was safe from



his roving eyes. He treated the citizens of Uruk as his personal chattel, and trampled on their rights like a wild bull. In despair, the people appealed to Anu, the principal deity of the Sumerian pantheon. The Gods responded by creating an exact double of Gilgamesh. His name was Enkidu. He was Gilgamesh's equal in every respect—strength, vision and character. They fought, and whilst Gilgamesh did eventually prevail, it was not before Enkidu had checked his worst excesses and secured his agreement to work together to restore peace and harmony to Uruk. Thereafter, the two cooperated and collaborated as partners and not as competitors.

In the context of corporate governance,

this epic contains two messages. One, to get otherwise competing forces to work together, all parties must converge onto the same page and have comparable powers and authority to check and balance each other into collaboration and cooperation. And two, a new world (“peace in Uruk” or “balanced incentive” structures) cannot be created as an event. It is a process. All stakeholders must appreciate they are on a journey and they will reach their destination only if they learn to work together despite their differences.

These two messages should be internalised by the four divergent and often competing stakeholders that bear on Corporate India.

One, the management—the custodian of operational performance and, as indicated, driven understandably by the objectives of short-term financial metrics. Two, the independent directors who have a fiduciary obligation towards the minority shareholder and also a strategic responsibility to facilitate long-term growth and profitability. Three, the regulator whose role is to prescribe the rules and procedures of governance and to enforce it through broad-based juridical authority. And finally, the government, which is the lawmaker, but more pertinent in the context of governance, the agency for bringing corporates into the developmental net.

Currently, each of these stakeholders chant the same mantra of “good governance”, but they operate autonomously within their own spheres. There is no formal forum that brings them all together. The management and the independent directors do, of course, face each other at the quarterly board meetings, but the interface is constrained by the board agenda and time. The Gilgamesh solution would recommend that these spheres be perforated. It would posit that, squeezed between the demands of the shareholder on one side, and the expectations of society on the other, there is a passageway that balances the interests of the shareholder and society. And that the four stakeholders should find this space and move into it as coequal and collaborative partners. They will not find it easy given their differences, but if they did so, they could eventually flip the current zero-sum dilemma of governance into a positive-sum outcome of balanced incentives.