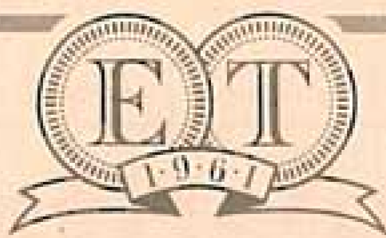

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Guest Column

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Who gets the subsidy?

Critics have often frowned upon giving subsidy to producers. In the context of fertiliser subsidy, in the early '90s, some economists opined that half the subsidies went to the producers and the rest to farmers. During 1998-99, total subsidy payments on domestic urea were to the tune of Rs 7360 crore. Going by theory of 50 per cent, out of this, Rs 3680 crore went to producers. Being a rich class, they need not be subsidised. Consequently, the government could have saved this much amount.

Carrying the argument further, if the government had denied subsidy to producers ever since the scheme was introduced more than two decades ago, total savings would have been monumental. The fiscal deficit would have been correspondingly lower. But, why hasn't the government acted upon to tap this huge potential? It is not as if the government is not keen to reduce subsidy. On the contrary, subsidy reduction is a high priority item on its agenda.

However, problem lies in the fact that economists are looking for savings in an area where these do not really exist. The very premise that subsidy accrues to producers is fundamentally flawed. To get to bottom of the truth, we need to know as to how the subsidy arises. In plain words, the government of India directs producers to sell urea at a low price. In a world of inflation, reasonable cost of production and distribution being higher, producer is bound to incur a loss. To prevent this and enable him earn a reasonable return on investment, excess of cost over net-back from sales is reimbursed under retention pricing scheme (RPS).

In the absence of control on selling price, producer would have sold urea at higher market determined price. And, since, the RPS is expected to more or less cover reasonable cost of majority of units (a producer who cannot, would wind up), there would be no need for any compensation. But, having controlled price at an artificially low level, and yet, induced entrepreneur to invest on specific promise of compensating consequential loss, it would be illogical to brand this as dole to him.

It may be pertinent to draw a parallel with the petroleum sector. The refineries are directed to sell kerosene, LPG, etc., to consumers at a low price unrelated to the cost, which is higher. The excess of latter over former is supported from OPA to prevent loss to refineries. This cannot logically be treated as subsidy to refineries; instead, it is subsidy to consumers as without it, they would have paid more. This indeed, is the way it is widely perceived.

In fertilisers too, but for subsidy support, farmers would have paid a higher market determined price. Since, subsidy helps in maintaining price at a low level, it follows that it accrues entirely to them. The ball does not stop here. Considering that low fertiliser price helps in reducing production cost of foodgrains and other agricultural commodities and, in turn, their selling prices, subsidy is, in effect, to consumers.

The government could have directly subsidised sale of fertilisers, i.e., the way it does for foodgrains. However, it chose to give subsidy through a handful of producers to save on cost of administration and to prevent misuse. Thus, producers are only a conduit for transmitting subsidy to farmers/consumers and not its beneficiaries.

But, why do economists insist that subsidy accrues to industry? They do so on the basis that it supplies urea at a cost higher than that of imported urea. The implicit assumption is that imports by India — irrespective of quantum — will not upset prevailing international price. This is factually incorrect as India and China are major players in world market and variations in their import demand has a significant impact on price.

The use of import price as benchmark can lead to a highly misleading conclusion. For instance, at prevailing C&F cost of US $85 per tonne, farmgate cost of imported urea works out to Rs 5000 per tonne. The corresponding cost of domestic urea being about R 8500 per tonne, subsidy to domestic units may appear to be Rs 3500 per tonne. This is illusory as the moment India steps up imports to replace domestic output, international price will shoot up and settle at a higher level depending on quantum of imports (e.g., during 199596, US $240.0 per tonne C&F at 3.7 million tonnes). And, yet, by giving a price of only Rs 5000 per tonne to domestic units, the government would have made them unviable on the one hand and on the other, it would have landed up paying more subsidy on imports.

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