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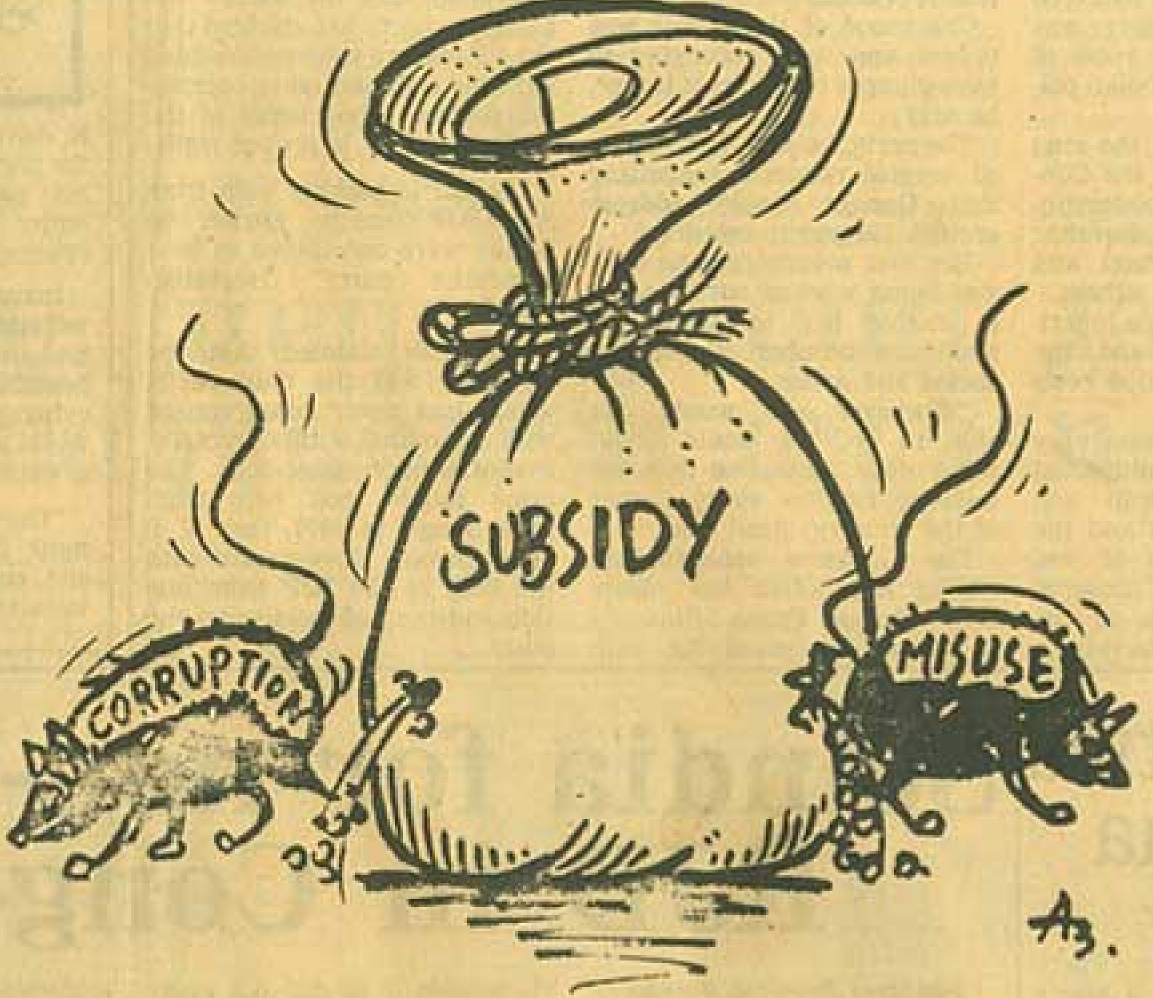
Not an unmitigated evil

The problem is not with fertiliser subsidy but primarily one of inefficiency, says Uttam Gupta



SUBSIDIES are a global phenomenon. In fact, these exist on a much larger scale in the developed countries than in developing countries. However, the latter alone are the talking point of discussion in various fora. Because of its seemingly substantial magnitude — estimate doing the round is about Rs 130 thousand crore — India is the centre of attraction and has often received lectures on how to go about reducing subsidies, maybe aiming at their complete elimination.

Interestingly, the lectures are given by none other than the representatives of the developed countries. In this series, recently, Mr Perc Barnevik, the topmost European honcho, is reported to have told the Indian political bosses to withdraw the subsidies and spend the money thus saved, on primary education, female literacy, safety network for the jobless and infrastructure. He was also quick to point out that this would involve little pain.

The politicians too were reportedly in agreement, but mentioned the difficulties in implementing the necessary steps in raising the prices of kerosene, urea and electricity supplied to the farmers etc. Essentially they were constrained by the fear of not getting re-elected.

The foreigner has sought to oversimplify a problem that has intricate dimensions. Perhaps, he has a feeling that cheques/drafts/cash aggregating to Rs 130 thousand crore are being distributed to the so-called beneficiaries, i e farmers, consumers etc. And, all that the government needs to do is to redirect these to other target groups.

While Mr Barnevik may be excused for lack of knowledge about Indian conditions, our topbrass ought to know as to who are the real beneficiaries of subsidies and where the money is actually going. Will the government really have the funds in hand; should it decide to do away with all the subsidies? And so on.

One has only to take a close look at the mechanics of subsidy to know that all and sundry including the government itself, are contributing to ballooning subsidies — not only the hapless farmers or poor consumers of foodgrains, kerosene and electricity etc, with whom these are invariably identified.

Consider fertilisers which figure uppermost on the subsidy agenda. Government controls their selling price at a low level and also fixes fair ex-factory price to the producer. The excess of latter over the former is reimbursed as subsidy to the producer. Subsidy is that portion of cost which the farmer does not pay.

The selling prices of petroleum products such as kerosene and LPG are also controlled. The excess of cost incurred by refineries in producing these over the net-back from selling is subsidy. However, unlike fertilisers, there is little transparency about how costs are determined. That leaves a lot of room for delay/inefficiency in setting up projects and resultant cost increases passing muster as subsidy to hapless consumers.

In respect of electricity, unlike fertilisers and petroleum products, there is no system of allowing cost. From the balancesheet of the SEBs, you have to read total expenses and realisation from sale. The excess of the former over the latter is SEBs' loss which is treated as subsidy on sale of electricity. Several SEBs do not even make a balancesheet. In such cases, wild guesses are at work.

The position in respect of other products/services provided by government undertakings/departments, such as road transport corporations/irrigation is broadly similar, i e no norms/accountability with respect to efficiency even as excess of all cost incurred over the sale realisation is treated as subsidy.

The government keeps on raising the administered prices of various feedstocks, utilities and services at its sweet will. Recently for instance, prices of naphtha, fuel oil and LSHS were raised by 40-64 per cent. These defy all norms, e g ex-refinery price of naphtha is fixed at Rs 7624 per tonne against IMPP of about Rs 5800 per tonne, and even reasonable production cost being of this level. All this leads to soaring production cost of fertilisers and in turn subsidy, as selling prices cannot be raised in tandem.

The government gathers huge funds by way of taxes and duties on petroleum products. During 1996-97, these were a whopping about Rs 30,000 crore. These duties raise the cost steeply which users cannot absorb. Subsidy is, thus, bound to rise. While the government enjoys the fruits, it is the users of kerosene/LPG and fertilisers who are branded as the beneficiaries of subsidy.

On the electricity front, inefficiencies in generation on the one hand and transmission and distribution (T&D) losses on the other are the prime cause for losses. Ironically, the bulk of so-called T&D losses are, in fact, electricity actually used, but not paid for. This is because of the rampant practice of not metering or doctored metering of electricity despatched.

In respect of irrigation, while policymakers cry wolf about only a small portion of the operation and maintenance cost being recovered, the problem is largely with state machinery which simply does not bother to collect irrigation charges. This is either due to lack of manpower, or the staff is perhaps not happy with the money going into the exchequer.

To an extent, the products/services are under-priced, or available virtually free of cost. For instance, power supply to farmers in various states, low irrigation charges or low urea price. But, that would explain only a small portion of the subsidy. The real subsidy is represented by inefficiencies in production, distribution and collection systems, huge taxes and duties collected by the government/state governments and unjustifiably high profits of government undertakings, especially in the petroleum sector.

That makes the issue far more complicated than it would appear on the face of it. Raising prices of kerosene, power, urea etc, no doubt presents difficulties. After all, these are used by millions of poor families whose capacity to pay is extremely limited. Despite this, even if it were possible to raise prices to reasonable levels of, say, prices paid by consumers abroad, the problem of managing subsidy would still remain.

To tackle this, we need to ask whether the government can do with substantially reduced collections of tax, especially from the petroleum sector. Can it improve the efficiency levels in production and distribution of various products and services? Can it stop the misuse of the official machinery for personal ends which contribute to poor recovery for use of water, power etc?

The problem is not with the subsidy per se; it is primarily one of inefficiencies, misuse/corruption. It is this that leads to ever widening gap between the cost on the one hand, and proceeds from sale of the products/services on the other.