

Pitfalls of targeted subsidies

OF LATE, there has been an increasing emphasis on directly subsidising users, instead of routing subsidies through producers or suppliers. The votaries of the former believe that the second approach lacks focus and is non-transparent. A review of the experiment in the fertiliser sector in the 1990s gives a good idea of how users would be placed on the direct subsidy route.

In March 1976, when subsidies were first introduced (a flat rate of Rs. 1,250 per tonne of P_2O_5) on all phosphatic fertilisers, subsidy money (equivalent to the relevant subsidy rate, for instance, Rs. 575 per tonne of DAP multiplied by production) was given to the manufacturers. The manufacturers, in turn, were expected to reduce the reasonable cost of production and distribution (farmgate cost) to the extent of the subsidy amount while fixing the selling price.

This scheme was replaced by the retention pricing and subsidy scheme (RPS) in February 1979. Under RPS, even as the Government directly controlled the selling price to farmers at a low and uniform level, any excess of reasonable farmgate cost over this was reimbursed as subsidy to the manufacturers. Although the manufacturers were the recipients of the subsidy, it was, in fact, going to the farmers by way of a lower selling price.

As for fertiliser imports — these were canalised all through — the subsidy represented the excess of C&F landed cost plus handling charges over the controlled selling price. However, no payment of subsidy was involved. The imports being on Government account, the handling agencies (nominated on the basis of competitive bidding) were expected to pay the Government an amount equal to the selling price minus the handling charges.

The system was a great success. The domestic production of nitrogen (N) and phosphorus (P) increased from three million tonnes in 1980-81 to 9.04 million tonnes in 1990-91. This helped in increasing their consumption from 4.89 million tonnes in 1980-81 to 11.21 million tonnes in 1990-91. The consumption of potassium (K) — not produced in the country due to the absence of indigenous raw materials — increased from 624 thousand tonnes to 1.33 million tonnes. As a result, the foodgrains production increased from about 129.6 million tonnes in 1980-81 to 176.4 million tonnes in 1990-91.

The RPS is administered by the Fertiliser Industry Coordination Committee (FICC) — an office under the Department of Fertilisers, Ministry of Chemicals and Fertilisers. The system is cost-effective and virtually free from misuse as the FICC has to deal with a limited number of manufacturers, thus enabling effective checks. This is in sharp contrast to the system of subsidising the supply of foodgrains under the Public Distribution System (PDS), which is cumbersome, entails high administrative costs and is prone to misuse.

Notwithstanding these factors, the Government experimented with the idea of directly subsidising farmers in August 1991, when it decided to exempt small and marginal farmers

Considering that target groups in the country run into millions, the weakness of the administrative apparatus, the flagrant misuse of authority by officials, and the dangers inherent in direct subsidising, are apparent. The targeting method has been tried several times, each ending in a fiasco, and the Government should refrain from experimenting further with the idea, says Uttam Gupta.

(those with cultivable land area up to two hectares) from the 30 per cent increase in the selling price of all fertilisers (except AS, CAN and ACI, already decontrolled in July 1991).

An allocation of about Rs. 405 crores was made in the Budget and each State received an amount equal to the estimated consumption by the target group multiplied by the price hike (for instance, urea Rs. 710 per tonne). The State governments, in turn, were expected to use this money to directly help small and marginal farmers even as the latter paid an enhanced price to the manufacturers/distributors.

It is a mystery how the States did it, but one thing is quite clear: The number of cultivating households in the small and marginal category being 65 millions and assuming that each farmer buys his requirement twice a year — corresponding to each season — this would have involved the handling and processing of about 130 million payments. This requires a vast administrative set-up, including a fully dedicated contingent of officials spread over the country. The present system is just not geared to effectively perform such a monumental task.

The scheme was a fiasco. This is evident from the Government's statement in Parliament that a meagre 3.5 per cent of the targeted farmers benefited from it. In any target-oriented scheme, there is ample scope for the non-target users to corner concessional supplies by purchasing these from the target group for a premium. In this case, however, the situation could have been much worse with funds diverted to some other use or even siphoned off. In early 1992-93, the scheme was quietly abandoned.

The concept of giving direct subsidy was tried again in September 1992. After the decontrol of P and K fertilisers in August that year, the Government introduced the scheme of *ad hoc* concessions to cover these products. Under the scheme, concession was provided at prescribed rates; for instance, Rs. 1,000 per tonne of DAP; and funds were made available to the States in proportion to the estimated sale of these fertilisers multiplied by the amount of concession. The State governments were expected to formulate and implement suitable schemes to directly reach the farmers.

For several months, there was total confusion leading to suspension of sales as the States did not know what to do. However, eventually, they sought industry's help to implement the scheme. The arrangement was that while the manufacturers would lower prices by the amount of the concession, the same would be

reimbursed by the State governments. In 1993-94, even as the Centre continued to release funds to the States, the latter rode piggyback on industry's shoulders for administering the scheme.

If the subsidy had to be administered only through industry, then why could the Government not release funds directly to the manufacturers as done under the flat subsidy scheme between March 1976 and February 1979, and thereafter under RPS until August 1992, and as it continues even today for urea? Why involve the State governments? As it is, the result was a steep decline in the consumption of phosphorus from 3.32 million tonnes in 1991-92 to 2.67 million tonnes in 1993-94 and of potassium from 1.36 million tonnes to 908 thousand tonnes.

The State-level politicians and bureaucrats also played a obstructionist role. They delayed finalising and notifying implementation guidelines; they fixed selling prices — in lieu of subsidy — at artificially low levels; some States issued fiat to manufacturers to sell only through institutional agencies despite their lack of infrastructure and funds; and, worst, they delayed payments to the manufacturers, at times even making short payments. There were also instances of States utilising subsidy funds for purposes other than reaching concessions to the farmers.

From 1994-95, though the State governments were no longer required to be directly involved in payments, their involvement continued inasmuch as they had to furnish a certificate that material was actually sold at concessional rates, before the Centre paid the manufacturers. The writ of the States, therefore, continued and distortions persisted. In 1995-96, the consumption of phosphorus (2.90 million tonnes) and potassium (1.16 million tonnes) was still significantly lower than in 1991-92.

In July 1996, even as the concession amount was raised steeply (for instance, DAP by Rs. 2,000 per tonne), the Government still insisted on the verification reports before releasing payments. The anticipated recovery in consumption did not materialise. The consumption of phosphorus increased only marginally from 2.9 million tonnes in 1995-96 to 2.99 million tonnes in 1996-97. The use of potassium declined from 1.16 million tonnes to 1.05 million tonnes.

Beginning 1997-98, two changes have been made: (i) The Government fixes the selling prices in consultation with industry and (ii) it pro-

poses to make 80 per cent on-account payment without waiting for a verification report.

Although this may improve the payments position, the dominant role of the States remains. Consequently, things are unlikely to improve unless the requirement for certification is done away with altogether.

A verification report may be required to check the authenticity of the claim, but a certification by the statutory auditors should be enough. In fact, this has been the practice all along.

Considering that the selling price is high even after concession (Rs. 8,300 per tonne DAP), the possibility of sales without passing on the concession is ruled out. Moreover, the fact that prices are notified and widely publicised acts as a further deterrent. Also, overall monitoring can be done to detect misuse.

The States neither have the wherewithal to monitor every sale transaction, which some are currently seeking to do, nor is it necessary. And yet, if the present system continues, there is a big risk of distortions creeping in which may frustrate the very objective of providing concessions.

In a situation where the target group runs into millions, the pitfalls of giving direct concessions are obvious. The weakness of the administrative apparatus and the flagrant misuse of authority by officials make things worse. In view of this, the Government should refrain from experimenting further as it would only lead to the wastage of precious resources without achieving the desired results.

Some believe that the indirect method of subsidising makes rich farmers even richer and should, therefore, be discouraged. Who are rich farmers? Taking 10 hectares or above as the basis, according to a NCAER survey, they are a meagre 2.6 per cent of total cultivator households and account for 18.7 per cent of cultivated landed area, but have a share of only 11.2 per cent in fertiliser consumption.

In contrast, farmers in the 2-10 ha range make up about 32 per cent, own 56 per cent of the cultivated area and account for 58 per cent of the consumption. Farmers with holdings up to two hectares — commonly known as small and marginal farmers — form 65.5 per cent, their share in cultivated area is 25.4 per cent and they account for 31 per cent of the fertiliser consumption.

On the agricultural landscape, therefore, the rich farmers form a small island. Subsidy administration and pricing policies for inputs cannot be guided only on the basis of how it will impact a small group; instead, it should take into account the interests of the majority. Even with regard to rich farmers, they cannot be expected to grow foodgrains crops (which are less profitable) and sell them cheap, unless inputs, including fertilisers, are reasonably priced.

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