Editorial

25 February, 2003

THE HINDU **BUSINESS LINE**

Pitfalls of targeting subsidies

Though there is justification behind the NIPFP's proposal to the Finance Ministry that all subsidies be given 'directly' to the intended beneficiaries and made 'transparent', the Government should carefully evaluate the pros and cons of direct support to farmers/ consumers in the light of the ground realities, points out **Uttam Gupta**.

IN a recent presentation made to the Ministry of Finance, the National Institute of Public Finance and Policy (NIPFP) suggested that all subsidies be given 'directly' to the intended beneficiaries and made 'transparent'. The NIPFP has merely reiterated the paradigm shift being emphasised by the Government for quite some time now.

The main subsidies are on food, fertilisers, kerosene, LPG, power, irrigation.

In respect of fertilisers, the Government directs their producers and importers to sell at a pre-determined price that is invariably lower than cost of production (C&F cost, in the case of imports) and distribution. The difference between the two is represented by subsidy and is paid by the Government.

In the power sector, State governments direct the State electricity boards (SEBs) concerned to supply electricity to farmers at a rate lower than the cost of generation, transmission and distribution. The difference gets camouflaged in losses of the SEB. Likewise, charges for irrigation are significantly lower than the cost of supply. The shortfall is met from the State Budget.

In foodgrains, the Government arranges for their sale to consumers through a widespread network of fair-price shops at a price lower than the cost of procurement, handling and distribution (commonly known as the economic cost). The excess of the latter over the former is subsidy on food and is given from the Union Budget.

In regard to kerosene and LPG, under the erstwhile administered price mechanism (APM), subsidy on these products was supported by surplus generated from sale of other petroleum products, such as petrol, diesel, aviation turbine fuel, naphtha and so on.

Following dismantling of APM from April 1, 2002 the Government is expected to reimburse oil companies from the Central Budget.

In all such arrangements, the manufacturer/supplier sells the product at a price lower than cost of supply and gets compensated for the shortfall from the Central/State Budget. Alternatively, subsidy could be given directly to farmers/consumers. The protagonists of this approach argue that this mode would help in better 'targeting' of the subsidy and making this 'transparent'.

Various committees of the Government have also recommended adoption of this mode. Thus, the Expenditure Reforms Commission (ERC) (2000) recommended giving cash coupons to farmers for subsidising specified quantities of fertilisers. Likewise, the Abhijit Sen Panel on Long-Term Grains Policy has recommended giving direct income support to the farmers.

One fails to understand why the existing dispensation of routing subsidy through producers is perceived to be non-transparent. Consider subsidy on fertilisers. Each year, the Government notifies in the Union Budget the quantum of subsidy.

The subsidy rate, the method used for its determination and all other relevant details are open to anyone. In fact, the information is made available to Parliament from time to time.

It isnecessary that Government brings to public knowledge the method and the calculations used for arriving at the subsidy.

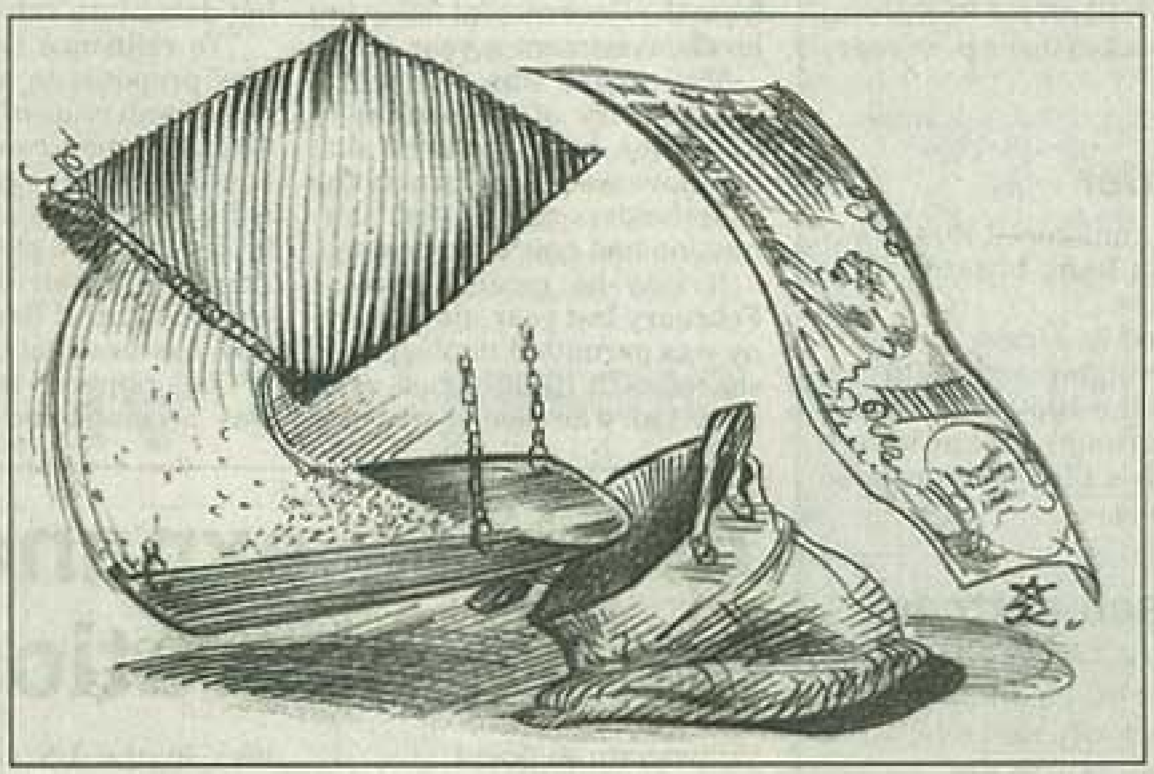
On the food front, there have been reports of 'inefficiencies' and 'irregularities' in the supply-chain that passes for subsidy to consumers. However, the problem can be tackled by adopting 'normative' principles for allowing costs. The States should follow suit in regard to administration of power and irrigation subsidy.

As regards 'targeting', theoretically, there may appear to be some merit in giving subsidy directly. This is because the system may help differentiate the poor from the rich. Moreover, by giving subsidy only to the former, the Government could also bring about saving in subsidy. However, this requires a careful scrutiny.

Who is a poor farmer? Under the WTO, the Government has availed of exemption of subsidy attributable to farmers having cultivable land holding less than two hectares from reduction commitments on the grounds that they are poor. Now, if, it adopts this as the basis for targeting subsidy, millions of poor farmers (those at the margin and others having less fertile land) would get excluded.

A related question is how will Government identify the so-called poor farmers? A prerequisite for this is the existence of complete and exhaustive land records of all the farmers. But these records are either non-existent or woefully lacking. Even if the authorities make an attempt, this exercise by itself, will take years perhaps, decades!

It may be pertinent to recall that in 1996, the then Prime Minister, Mr H. D. Deve Gowda, had announced launching of the Targeted Public Distribution System (TPDS) to provide foodgrains to the families living below the poverty line (BPL) at a special price. Even seven years since, most of the State governments have not been able to identify the BPL families!



The next imponderable pertains to actual disbursement of subsidy to the target group. The task involves distributing cash or coupons convertible in to cash (as recommended by ERC in respect of subsidy on fertilisers) to millions of farmers every year.

The required administrative effort would be no less than that involved in holding a General Election! The poor farmers need to be protected against frequent changes in prices of inputs (for instance, the price of naphtha — feedstock used for manufacture of fertiliser — is revised every 'fortnight'). This would require distributing additional cash/coupons to cover the increase in cost. The exercise will have to be undertaken several times in a year.

Is the State machinery adequately equipped for the above task? To get a suitable answer, let us look at the following. In 1991, when the Government raised the selling price of fertilisers by 30 per cent, it also decided to exempt farmers with holdings of up to two hectares from this hike. The subsidy amount was distributed among the States to be given directly to these beneficiaries.

Subsequently, in a reply to a question in Parliament, the Government stated that a meagre 3.5 per cent of farmers actually got the benefit of subsidy. The scheme was given a quiet burial from the following year, 2002-03. This is a clear manifestation not only of the inability of the State administration to run the scheme, but also the possibility of its misuse.

A couple of years later, in response to a query by the High-Powered Fertiliser Pricing Policy Review Committee (HPC) (1998), the majority of State governments had stated that they were not in a position to implement a scheme of reaching out fertiliser subsidy directly to farmers. It is a different matter that the Committee still recommended that the States should make efforts in this direction. Thereafter, the ERC (2000) recommended that purchases of a specified quantity of fertilisers (determined with reference to the need of a 'subsistence' farmer) by any farmer would be entitled to subsidy. This way, even as the Commission was able to get over the problem of having to identify poor farmers, it did not dwell upon the other imponderables in reaching out direct assistance to them.

The concept of giving direct support to the target group has been imported from the developed countries. But the situation in India is vastly different. Because of the sheer size of the population that needs to be covered, this approach becomes impractical.

Further, in view of our poor standards of governance, its efficacy is doubtful. And, yet, if it is adopted, it will only result in wasting of resources.

But there is wastage and misuse even under the existing regime (it is even alleged that a significant portion of subsidy is cornered by the producers). In any system where a payout from Government coffers is involved, there is nothing unusual about this. But the moot question here is whether the system is cost-effective and amenable to effective control.

On this score, clearly, the existing system has an edge. Since the Government has to deal only with a handful of companies, the cost of administration is low.

This also helps minimise the possibility of misuse. In sharp contrast, under a regime of direct support to farmers/consumers, it would be virtually impossible to keep track of millions of payments handled by thousands of officials and fix accountability.

In this era of reforms, from public pronouncements and recommendations of various Committees, including the ERC, it would appear that the Government has already made up its mind to switch over to a dispensation of providing direct subsidy to the intended beneficiaries. However, before taking the plunge, it should carefully evaluate the pros and cons in the light of the ground realities.

(The author is Additional Director — Economics — Fertiliser Association of India, New Delhi. His views are personal.)