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The case for subsidy

The problem is not subsidy, but the extreme swings in approach, says **Uttam Gupta**

ALL along, farmers had suffered because they got less for their farm output while paying more for the inputs used in production as also purchase of industrial products for personal consumption.

The subsidy regimes on agricultural inputs were instituted primarily to compensate for these negatives. Despite these, the terms of trade progressively moved against agriculture. And yet, finance minister Manmohan Singh has made a strong case against subsidised supply of inputs to farmers on two planks. First, the mounting subsidy burden has impaired the capacity of the governments at the Centre and states to sustain public sector investment in agriculture. Second, the government's reform policies aim at eliminating protection to the industries. Consequently, there is no need for compensatory support mechanisms like subsidies on inputs.

Let us take up the first argument. Consider fertilisers which accounts for bulk of the explicit subsidies on agricultural inputs. Increase in administered prices of inputs, utilities and services supplied to the fertiliser plants by government-owned corporations was responsible for 90 per cent of the increase in subsidy. For instance, an increase in the price of naphtha adds to the realisation and consequently, profits of the IOC/HPC etc. The actual fertiliser subsidy may be somewhat more than the extra revenue realised by IOC/HPC as various local taxes also increased proportionately and have to be compensated under the administered pricing scheme for fertilisers. Nevertheless, this money also comes back to the concerned state governments.

Consider subsidy on power for which there is no explicit budgetary allocation, but is indirectly supported as losses of SEBs. But, here again, the predominant reason for mounting pressure on the government's budget i.e., inefficiencies in operations, excessive manpower and gross mismanagement of the SEBs, get no attention at all. This means that even if the farmers were to be charged reasonable rates for power (based on efficiency criteria), the losses of SEBs would continue to be substantial with attendant drain on exchequer.

An objective appreciation of the subsidy on credit is also needed. The interest rates are not determined in a competitive manner; instead, these are directed by the RBI, despite recent deregulation. Presently, on short term loan, the farmers pay from 10 to 12 per cent. These are clearly lower than the rates charged to the industrial customers. But, we should not forget that the latter have access to equity finance, which is virtually free of cost.

The second argument resting on the premises of reforming industries, too, does not have much appeal. For instance, the positive impacts of lowered custom and excise duty rates are more than offset by substantial depreciation of the rupee and hike in administered price of basic inputs like hydrocarbon feedstocks, power and railway freight etc. Local taxes have worsened the situation.

Free access to the international market is unlikely to help farmers to secure inputs at the best price. Global markets far from being competitive, are highly cartelised. Both the supplies and prices are subject to widespread manipulation by a few suppliers. In fact, in a span of just one year, international price of urea and DAP went up by as much as $120 and $110 per tonne respectively. Likewise, free access does not guarantee a good price for agricultural exports.

In this background, it will be grossly unfair and improper to expect the farmers to do without subsidy on inputs. While, the better lot amongst the agricultural community might possibly take care of themselves and even prosper in the market driven regime, there is a vast ocean of 75 million small and marginal farmers who have meagre purchasing power and for whom farm mechanisation is a distant dream.

Consequently, they have no chance of benefitting from the so-called globalisation of Indian agriculture. In a sweeping drive of subsidy elimination, they will be the ones who will perish and the country can ill-afford such a big risk.

Subsidy reduction does not necessarily result in extra resources for funding investment in irrigation and infrastructure etc. During the last few years, various measures like decontrol of P and K fertilisers did not bring about the desired reduction even as subsidy on urea which is still under control, continued to increase caused mainly by administered price hikes. Moreover, whatever resources were saved due to the former did not lead to corresponding increase in spending on building infrastructure in agriculture.

The problem of declining investment in agriculture has to be viewed in the much larger perspective of majority of the state governments being financially bankrupt. Subsidy is only one small dimension of the state of affairs. The key factor is too much spending on the act of governance besides inefficiencies and mismanagement of the resources. Several thousands of crores have been allocated, in the past, for various programmes like IRDP, REP, food for work programme etc. The main thrust of these programmes has been on creation of assets in rural areas which is mainly on agricultural activities. And yet, the investment has declined. Where did this money go?

The problems is not really one of lack of money, but is primarily with those who manage the affairs and are in charge of spending the money. Against this background, even if all subsidies are abolished, what is the guarantee that the money thus saved will be used for building agricultural infrastructure.

There can be no two opinions on the need to reverse the present declining trend of investment in agriculture.

However, it would be dangerous to pursue this at the cost of reducing the use of vital inputs. The latter will inevitably follow in the event of mindlessly pursuing the goal of eliminating subsidy. Remember the steep decline in use of phosphatic and potassic fertilisers due to their sudden decontrol in 1992. This can happen to urea if the government abruptly decides to decontrol this segment of the industry as well.

The problem is extreme swings in approach; from too much pre-occupation with subsidy in 70s and 80s to emphasis on no subsidy at all in the 90s. What the country needs is effective subsidy management in a coordinated and integrated framework incorporating both the backward and forward linkages and making every one in the chain accountable. Amongst others, this will have to encompass the oil and the gas sector, power, railways and even the food supply and distribution systems.

This will, however, be possible only if we stop treating subsidy as a stigma which unfortunately, has been the case so far. After all, we should not forget that the OECD countries from whom we have learnt the mantra of subsidy removal, had a subsidy budget of $180 billion in 1990 accounting for almost 50 per cent of their farm incomes. The amount could not have been less now notwithstanding the new WTO.