The Observer of Business and Politics October 26, 1993

Double standards on subsidy

De-subsidisation of agriculture must reckon with heavy farm protection in the developed world, says **Uttam Gupta**

AGRICULTURAL subsidies in the developing countries are in the process of being phased out, as the bulldozer of market oriented economic reforms marches ahead. Let us for a moment look at what is happening in the developed countries which have influenced, if not set, our agenda for eliminating subsidy. Agriculture in the US employs only about 2.2 per cent of the work force and contributes only 2.8 per cent of the GDP. Despite this, agriculture is heavily subsidised. Subsidies primarily take three forms: Price support, income support and export subsidy (mainly through concessional export credit).

Price support enables a farmer to realise a certain minimum price, known as the loan rate, irrespective of the market conditions. If the market price is higher, the farmer is free to exercise that option. Income support is a cash support taking the form of a "deficiency payment" and equals the target price minus the market price or loan rate (whichever is higher). The target price is a price that the US Department of Agriculture thinks farmers must get irrespective of the market price. However, the farmers are entitled to these subsidies only if they participate in the supply management programme christened as Area Reduction Programme

Under this, for whatever area remains uncultivated, the farmer is paid a pre-determined portion (85 per cent of the actual yield) as compensation.

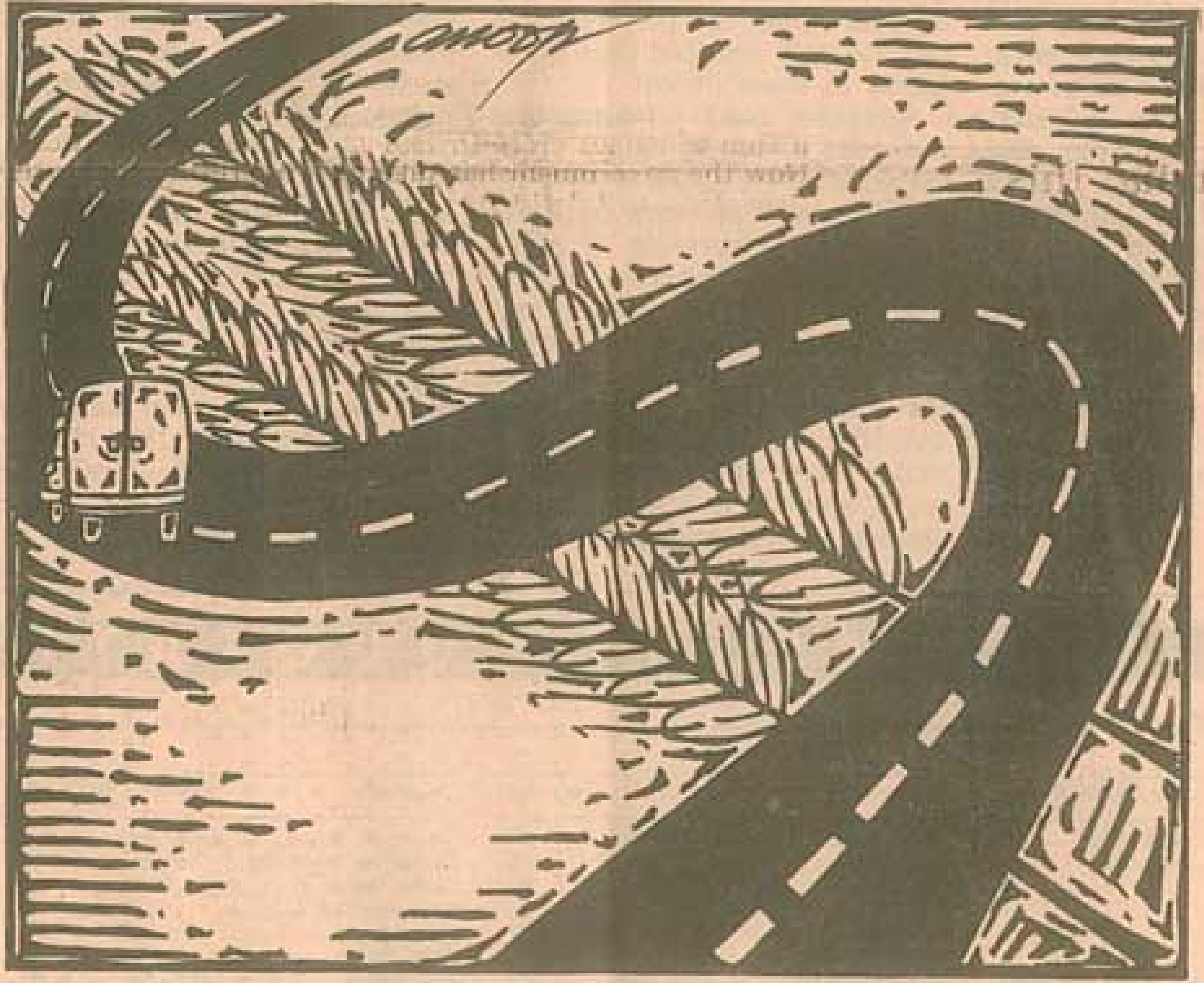
Besides, the US administration runs what is commonly known as the Export Enhancement Programme. Under it, export proceeds are pegged at the level EEC produce is likely to sell in the importing countries. The American farmer is reimbursed the excess of his cost of production and distribution over the fob realisation at this predetermined price. The US efforts to stay in international business for farm products are backed up by strong market intelligence that monitors prices of EEC products on a weekly basis.

In short, the American farmers are enabled to produce less and still realise high income levels through various subsidies. The gross income of an average American farmer (average holding size of 700 acres) is about $100,000 per annum which translates to a net income of about $25,000 per annum. In 1990, US farmers got $47 billion as government subsidies and, additionally, $28 billion by way of higher prices paid by consumers.

The EC countries, Japan and Canada too are very much in the race attempting to outsmart each other in their bid to appease their agricultural population which may be insignificant economically, but not politically.

The EC subsidies have three incarnations: Domestic or internal, export subsidies and protection against cheaper imports. The first two are patterned more or less on the same lines as in the US. The third works like a shield against cheaper imports. A "threshold" price is set at a level equal to the target price minus the cost of unloading and transporting the imported product to major sales centres. Imports are permitted if the import price is equal to or higher than this level. If it is lower, an import duty is imposed to raise it to the threshold level. In 1990, the EC spent $49 billion on farm subsidies. The farmers got an extra $85 billion through higher consumer prices.

Likewise, agriculture in Japan is heavily subsidised through the supply of subsidised inputs such as fertilisers, price support for produce and import quotas, duties and state trading in agricultural goods.



In Canada, too, agriculture is heavily subsidised. Expenditure by public authorities on various supports constitute 36 per cent of the value of agricultural production and around 2/3rd of net farm income.

Clearly, nowhere in the developed part of the world, is free market practised in agriculture. The large scale state intervention is geared primarily to boost incomes of the farmers (no matter whether they work on the farmland or not), to capture markets for agricultural products in the developing countries and to prevent cheaper imports from penetrating into their own markets.

No doubt, one of the mandates under the current round of GATT negotiations is to reduce agricultural subsidies in the developed countries. The chance that there could be even some progress appear to be remote. The not so publicised Blair House agreement, which envisaged significant cut in EC subsidy on oilseeds (about 30 per cent), is already in serious jeopardy following vociferous protest from French farmers.

While we liberalise at a fast pace, probably with the intention of going global with agro-based industries in the forefront, we should not be oblivious of the deep-rooted subsidy scenario in the developed countries. Despite inherent comparative advantage, we may still not be able to find a place for our products in the developed countries. That is dangerous, as having lost our own markets to foreign goods through reckless opening up of the economy, our BoP is bound to deteriorate, pushing us progressively towards still higher levels of external debt.

There is an urgent need for 'sensitising' thinking to the ground realities on the global scene and appropriate modification in our own strategies, the pace and sequencing of changes. In its latest assessment of the Government's policy with regard to elimination of fertiliser subsidy, even the World Bank has observed that sudden decontrol of phosphatic and potassic fertilisers was not the right step.

We have to take care of the interests of our industry and farmers to some extent at least, if not as much as the developed countries do. Towards this end, the imports of artificially low-priced DAP have to be regulated; or else the indigenous industry will be completely wiped out.

This may be achieved either through levy of customs duty at about 20 per cent or quick action under the anti-dumping law. And, we need not be ashamed of it as this is the practice the world over. We should not forget that cheap imports cannot be taken for granted for ever and international suppliers would take our farmers for a ride the day our own industry is unable to provide reasonable supplies.

In the case of urea, let us not commit the same folly as in DAP, although some increase in selling price may be allowed while retaining controls.

With regard to food imports, whether we have BoP difficulties or not, we must reserve the right to regulate them. Unfettered entry of MNCs in this area would be disastrous not only for our farmers but also, for the country's food security.

On the credit front, farmers need more money to finance the increased expenses on farming. Therefore, let us not suddenly dismantle priority sector lending.

On electricity, while we must give up the concept of supply free of cost, the tariff should be increased only gradually. In other areas too, the policy reorientations need to be carefully orchestrated to ensure that we do not land up undoing what we already have.