The Observer of Business and Politics January 4, 1994

Who is being subsidised?

Attention should be focussed on factors that raise the cost of production and distribution, says **Uttam Gupta**

RECENT reports on the government's deliberation on an increase in the price of LPG and kerosene will dismay those already groaning under the burden of past hikes. However, popular sentiment is hardly an important consideration particularly when it concerns administered price hikes.

The government seems to be enamoured with the question of reducing, perhaps even eliminating, subsidy which, during 1992-93, was estimated at Rs 1,145 crore on LPG.

A somewhat circuitous logic is also playing its part. Some time back, the government had taken a decision on decanalising import of LPG and kerosene and permit its parallel, private marketing and distribution. The logic was that while the PDS would continue to cater to the poor at subsidised prices, those who could afford to pay a higher price would take advantage of augmented availability.

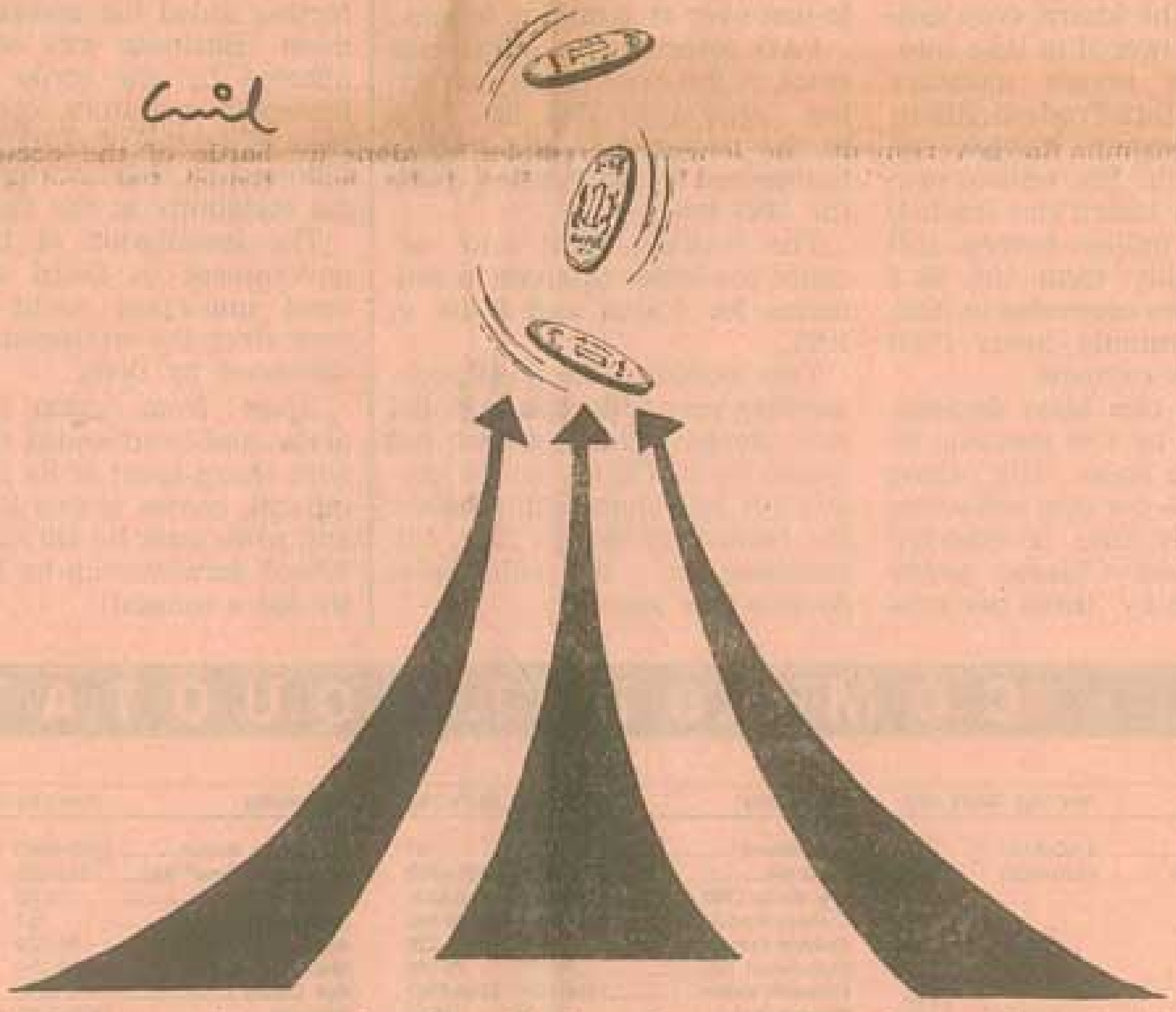
At the prevailing international price, the cost of a 14.2 kg LPG cylinder, excluding transportation costs, works out to Rs 186. The subsidised price of LPG is less than half that amount (for instance, in Delhi, it is Rs 82.75). Given this yawning gap, the argument followed its intrinsic logic: Unless the PDS selling price is also increased, there is a strong possibility of diversion of cylinders from PDS to the open market.

Consequently, if the former is raised with a view to bringing down the difference, the problem is automatically solved. Similar arguments are being used in respect of kerosene where the selling price through the private distribution network works out to Rs 6.65 per litre as against the current subsidised sale price of Rs 3 per litre through the PDS.

Whether to subsidise any item or not is a macro-economic decision to be taken in the context of national priorities. However, it appears that there is very little possibility, if any, of continuation of subsidies even on items which are consumed mostly by the poor. That being the overriding consideration, it is much better that these items are completely freed from pricing and distribution controls.

Although, considering mass poverty and the generally low purchasing power of the majority, such a step may be totally inadvisable, but relatively, that situation may be better than the present dispensation where the consumer has to pay about Rs 150 per cylinder (as is being contemplated) and yet be considered a beneficiary of the PDS. Under the existing arrangement, not only would he be paying for the inefficiencies of the PDS, but would also be denied the advantage of price reduction resulting from competition.

In dealing with the subsidy issue, we tend to oversimplify. Financial subsidy represents the difference between the cost of production and distribution on the one hand and selling price on the other. There is the concept of economic subsidies also which is the difference between the cost of imported product and the price paid by the consumers. But that is rarely talked of except in specific circumstances.



Invariably, our planners and policymakers are seized with financial subsidies only. That is the case when we talk of subsidies on foodgrains, fertilisers, LPG or kerosene.

There are several ways that subsidy can increase. First, even at constant unit selling price and cost levels, subsidy can rise purely on account of increase in production and consumption. Second, subsidy can rise when cost remaining constant, selling prices are reduced. But, that rarely happens (recent 10 per cent reduction in controlled selling price of urea in August, 1992, is an example). Third, subsidy can rise when the selling price remains constant, but, the cost goes up. This may be true of most essential commodities, including LPG and kerosene. But, we have a fourth situation when subsidy increase is due to an increase in the cost at a faster pace than increase in the selling price.

The last scenario is typical of foodgrains wherein the selling price of wheat and rice (issue price from the ration shop) in recent years have been increased and yet the subsidy on foodgrains has gone up. In fact, for the year 1993-94, we are talking of an outgo of about Rs 4,000 crore which is about Rs 1,000 crore higher than that in 1992-93.

Similar was the situation in fertilisers during 1991-92, when, despite a 30 per cent increase in controlled selling prices, the revised budget estimate for fertiliser subsidy was Rs 4,800 crore — Rs 400 crore more than in 1990-91. The actual requirement was placed at a much higher level of Rs 6,200 crore.

In a nutshell, our problem is that we only look at the growing subsidy numbers without bothering to analyse the causes. We expect the ultimate consumers to pay more just because subsidy under a particular head is growing. Why do we not focus attention on factors that raise the cost of production and distribution?

Throughout the 80s, and even in the early 90s, we have witnessed the rates of power, gas, coal, railway freight and steel increasing with impunity. Should there be no check on this? Or is it our case that all these price increases are sacrosanct?

Controls or no controls, subsidy or no subsidy, cost appears to be the most important consideration on subsidy. In this connection, let us face the startling fact that there is a 85 per cent customs duty on import of LPG.

Inclusive of this, the C&F landed cost of LPG works out to Rs 12,400 per tonne. In other words, the duty element alone is Rs 5,700 per tonne or Rs 5.7 per kg. For a 14.2 kg cylinder, this would work out to Rs 80.

The actual impact could be even more if one takes into account additional financing costs as also local taxes or duties levied on a percentage basis.

If the government does away with the customs duty on imported LPG, the cost of production and distribution of a 14.2 kg LPG cylinder would be reduced to a little over Rs 100. That will knock the bottom off arguments in support of a hike in price through the PDS. In fact, the government will have even achieved its objective of reducing subsidy without having hit consumers hard.

In the recent past, a similar effort has been made in the context of fertilisers. There used to be a 12 per cent customs duty on phosphoric acid imports (an intermediate in phosphatic fertiliser production) from Morocco and Tunisia and a 15 per cent duty on imports from other sources.

This was removed on August 27, 1992. The decision was taken on the basis of the recommendation of the JPC which did an exemplary job of addressing the fundamental causes of the growth in fertiliser subsidy.

The government will do well to initiate similar comprehensive studies with respect to LPG and kerosene in order to bring out the real factors which pushed subsidies on these essential items to ballooning levels. That, in turn, should help in tackling the subsidy syndrome in a manner that does not burden the poor.