

Economics and Politics of Farm Subsidies in India

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Economic policy prescriptions out of tune with political ground realities remain futile exercises and sterile in their impact on the political economy of the country. On the other hand, political decisions and policy dispensations not based on economic rationale wreak disaster on the financial health of the economy. There has to be, therefore, a functional synergy between rational economic analysis and political decision-making for healthy socio-economic growth and development as well as sturdy political values and governing systems of the country. Unfortunately, in almost all the governance systems of different countries, policy formation carries much deeper hues of political considerations, and economic realities are often blatantly ignored at the peril of the financial health of the economy and social equity.

There is no doubt that subsidies play an important role in a welfare state, both in respect of producer subsidies as well as consumer subsidies in terms of restoring equities and improving the income levels and living conditions of disadvantaged sections of society. Many years ago, in his book *Future Shock*, Irvin Toffler propounded the theory that, as the choice matrix expands with the development of technology, and multiple choices become available, fewer and fewer people make the right choices to succeed, and larger and larger

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proportions of the society fail to make the right choices. Hence, the burden of welfare falls on a smaller and smaller proportion of the successful population with heavier and heavier diversions of tax money for welfare purposes in the form of consumer and producer subsidies and income support programs. It is an inevitable road map for a continuous development process both in the developed as well as developing economies. Whereas consumer subsidies are meant to improve the access of disadvantaged sections of society to the necessities of life, such as food, fiber, and fuel, producer subsidies have multiple objectives to be achieved.

1. CONSUMER SUBSIDIES

Consumer subsidies, as for other subsidies, must be focused, and commodities meant for the targeted populations must reach the beneficiaries identified with a discriminating intellect so that, in the name of the poor and needy, the subsidies do not gravitate to undeserving sections of society. In India, subsidies are distributed in the form of rationed goods such as wheat grains, flour, rice, pulses, cooking oils, sugar, kerosene, etc. on ration cards of various categories such as ordinary cards, below poverty line yellow cards, etc. It is a known fact that, in the first place, significant numbers of ration cards get issued to undeserving families; a large part of these consumer goods are also pilfered and sold in the open market by the depot holders in connivance with officials of the concerned government department. According to the Planning Commission of India Survey of 2008, not more than 42% of subsidized food grains reach the targeted populations. This means that 58% of the food grain meant for the Public Distribution System finds its way onto the open market and never reaches the targeted populations. The story of other rationed goods provided through the Public Distribution System (PDS) cannot be very different. In the state of Punjab, this diversion is estimated to be around 90%, which therefore makes Punjab the most corrupt in the country. Yet the food subsidy burden on the exchequer in India has reached Rupees (INR) 723.7 billion in 2011–12 and is expected to be around INR 750 billion in 2012–13 (budget estimates). Subsidy on food grains alone amounts to more than INR 150 billion. This means that, if the leakage is not plugged, food grains alone worth 85 billion rupees, meant for the poor, would not reach them in the year 2012–13. This financial liability is when the poverty line is defined at expenditure of INR 21 per person per day for rural populations and INR 27 per person per day for urban populations. From the angle of nutritional deficiency, three-quarters of the population in India needs to be provided with subsidized food compared with about one-third of the population being at present defined as below poverty line beneficiaries. Again, the government

of India plans to provide 7 kg food grain at INR 1 per kg to the targeted below poverty line (BPL) families, and 3 kg at 50% price to the rest of the families in India, costing about INR 2 trillion, which would require about 65 million tons of food grain. This is a huge call on the physical and financial resources of the country. The government budget has provided for INR 3.5 trillion for the purpose, which also includes provision for enhancing production. It is a moot question as to what extent the governance system in place will be able to achieve the objectives of the scheme. All this requires unstinted commitment and a high level of efficiency at various levels of administration, of which there is a lack in the country.

Direct income support is advocated in many developing and developed countries, so that the benefit accrues to the targeted populations without any losses or pilfering at the hands of administrators and handlers of the products. We have examples of coupons and green stamps issued by food stores and other corporate depots as discounts, which can be used to buy the products of choice by the stamp/coupon holders. If direct income support is provided in hard cash, this can be easily used/misused for purposes other than food items. If, however, the direct income support is provided in the form of food stamps to be used only for specified food items, this will serve the purpose of providing the food to the needy. Even if these stamps are exchanged for money, the stamps cannot be used for any other purpose and ultimately will end up in the purchase of specified food items only. These food stamps can be encashed at specified banks after having been marked as used by the licensed depot holders and presented in the banks by these depot holders only. Banks in turn would claim the money from the government department(s) issuing these stamps. There will still be some diversion of the subsidy to other than food purposes, but its extent will be minimized through this system. Since a very large proportion of the BPL population, both farming and non-farming, lives in rural areas, this system will help the rural populations in improving their food security and will reduce considerably the extensive malnutrition particularly prevalent among vulnerable sections of rural society, such as children, women, and the elderly. Since the underprivileged sections of society, viz. schedule caste and backward class populations, are mainly in the rural areas, particularly so in Punjab, the system will help them considerably in respect of food security, access to food, and nutritional security.

No doubt food subsidies are an inevitable provision-claiming priority in the budget of any welfare state, yet a progressive increase in the subsidy bill and the number of persons covered in absolute and percentage terms should be a matter of grave concern, because it puts a heavy drain on the exchequer as is indicated in [Table 13.1](#). This is a huge burden on the state exchequer and is fast escalating with the passing of time, which amounts to an average escalation of INR 23.14 billion per year.

TABLE 13.1 Expenditure on Food Subsidy, Government of India, 1980–81 through 2011–12.

Year	Subsidy (billion INR)	Year	Subsidy (billion INR)
1980–81	6.50	2001–02	120.60
1985–86	16.50	2005–06	230.77
1990–91	24.50	2010–11	629.30
1995–96	53.77	2011–12	723.70

Source: Fertilizer Statistics, The Fertilizer Association of India, New Delhi.

2. AGRICULTURAL SUBSIDIES

Agricultural subsidies are given in several forms. Fertilizer subsidies come through the system of retention prices provided to the fertilizer producers (fertilizer factories). These prices are calculated on the basis of economic costs to the factories, based on their investments, running costs, and a margin of profit (say 12%), and the government then decides on the subsidized prices at which the fertilizers are sold to the farmers. Imported fertilizers are also provided to the farmers at subsidized prices. The factories have been resorting to the malpractices of excessive reporting of investments and working costs, known as *gold plating*, resulting in estimation of higher retention prices. Since every factory had a different level of investment and working costs, retention prices varied from factory to factory. Since the economic costs of every factory were paid, along with a profit margin, it sucked out the incentive to make improvements and introduce functional efficiency. Although on several occasions the international prices of fertilizers remained lower than the same fertilizers produced in India, the government was obliged to keep the domestic factories producing the fertilizers at higher costs due to the international prices being highly volatile in nature. Moreover, India being a major consumer of fertilizers, its entry into the market for purchase of fertilizers would instantly increase the international prices. Through time, however, the government has been trying to reduce these subsidies so that ultimately the market prices prevail and the fertilizer producers become more efficient, and farmers make rational use of the fertilizers. Yet, the effort has not succeeded and there remains a high element of subsidy in the supply of fertilizers to the farmers. [Table 13.2](#) depicts the escalation in the subsidy bill on fertilizers in the country. It is estimated that about 8% of this subsidy goes to Punjab farmers, cultivating only 2.5% percent of the cultivated area in the country.

Another important kind of subsidy is institutional credit. Agricultural credit has remained the major emphasis of the agriculture policy in India, and the

TABLE 13.2 Central Fertilizer Subsidy in India, 1980–81 through 2010–11.

Year	Subsidy (billion INR)	Year	Subsidy (billion INR)
1980–81	5.05	2000–01	138.00
1985–86	19.24	2005–06	184.60
1990–91	43.89	2008–09	966.03
1995–96	67.35	2010–11	499.81

Source: *Fertilizer Statistics, The Fertilizer Association of India, New Delhi.*

agricultural sector has been prioritized for lending by the banks. A minimum of 18% of the banks' exposure is mandatory for farm sector credit. Some dispensations were given to banks that could not meet this mandatory target. The defaulting banks could place the balance with NBARD (National Bank for Agriculture and Rural Development) or deposit the money with the Reserve Bank of India at a lower rate. NBARD uses this money for agricultural and rural infrastructure and development projects. Also, the farmers under debt have been given loan waivers on several occasions as a relief up to a certain limit. Now the farm loans are available at a 7% interest rate, which is far below the prime lending rates of the banks. Recently, subvention of 3% has been provided for those borrowers who return the loans on time.

Punjab farmers are considered to be under the heaviest debt in the country. The reason is that the lands, being two-crop irrigated lands, provide a high level of eligibility for production credit (crop loans) to the farmers in the state. The marginal, small, and medium size farmers in many cases divert these loans to unproductive purposes, like marriage of their children, medical treatment, or to meet other social obligations. When not used for productive purposes, this credit money does not generate matching repaying capacity, and loans become overdue and turn into bad debt, which sometimes leads to suicides. Paradoxically, whereas farm debt is one of the highest in Punjab, the credit/deposit ratio remains around 40%, which means that for every INR 100 deposited in the banks, Punjab utilizes only about INR 40 as credit from the institutional sources (banks). This is because the depositors are mainly from secondary and tertiary sectors of the state economy, and a considerable amount of deposits are from domestic savings from the cities; the borrowers are mainly farmers and industrialists who are under huge debt in the state.

The most controversial item of subsidy in the state is for water and electric power for tube-wells in the state. This subsidy would form about 38% of the total direct debt of Punjab, amounting to more than INR 87 billion by the end of the financial year 2012–13. The details are given in [Table 13.3](#).

TABLE 13.3 Revenue Expenditure on Subsidy to the Punjab State Electricity Board/Punjab State Power Corporation Limited (PSEB/PSPCL), 1996–97 through 2012–13.

Year	Power Subsidy (billion INR)	Year	Power Subsidy (billion INR)
1996–97	13.38	2004–05	21.70
1997–98	8.73	2005–06	15.51
1998–99	–	2006–07	14.24
1999–2000	4.04	2007–08	28.48
2000–01	6.05	2008–09	26.01
2001–02	4.48	2009–10	28.74
2002–03	7.50	2010–11	33.76
2003–04	13.51	2011–12	42.00

Source: Punjab budget documents, 2012–13

Budgetary estimates of power subsidy in 2012–13 are INR 60 billion. An important aspect of this power subsidy is that it is not reflected in the Minimum Support Prices (MSP) of the commodities that the national government procures from the farmers. These subsidies ultimately land in the pockets of the farmers only for those commodities that are sold in the open market, such as fruit and vegetables, pulses, oilseeds, maize, etc., which the government agencies do not procure. Even though MSP is prescribed for some 24 commodities in the country, effective procurement at the MSP is only for food grains. The Cotton Corporation of India does sometimes procure cotton, but it does so mainly for the government factories.

With the system of determining the minimum support prices, the cost of production estimated by the Commission for Agricultural Costs and Prices plays an important role. The cost of cultivation is estimated based on scientifically selected clusters of about nine thousand farms in the country. The data are collected on a daily basis through a cost-accounting method by regularly appointed supervisors. The data collection and its summary tables are made by the state universities, and is not influenced in any way. These summary tables are passed on to the Economic and Statistical Advisor in the Ministry of Agriculture of the Government of India. The Economic and Statistical Advisor works out the average cost of cultivation for all the crops covered under the MSP and forwards these to the Commission for Agricultural Costs and Prices, which uses these estimates after projecting the costs to the current crops. Such an extensive procedure cannot be ignored in determination of MSP, though

other factors like stocks in hand, international (border) prices, consumer price index, etc. do enter into the calculations of the commission.

The important point to note is that the system of cost calculations considers only the actual costs incurred by the farmer himself. No social costs incurred by the government, and suffered by society, is taken into account in the calculations of the commission. The once-a-week power cuts for industry and businesses as well as the domestic sector not only cost the government in terms of diverting the power from paying sectors to the non-paying sector, it adversely affects secondary and tertiary sector production and government tax income from the production and business volumes foregone.

Domestic sector suffering also has huge social costs. These costs calculated in monetary terms cannot be less than INR 50 billion. Adding this 50 billion to the INR 60 billion subsidy would make a total of INR 110 billion worth of direct social costs to the people of Punjab, which would never enter into the calculations of the commission. This subsidy and other related social costs are in fact the very heavy opportunity cost of producing the rice crop in the state. Since these costs are not considered by the commission in the calculation of the cost of production of agricultural commodities, to the extent that the cost of production is considered in the determination of minimum support prices, these prices remain lower than the actual economic cost of production of these commodities. As a consequence of lower procurement prices, the issue prices remain lower. Thus the real benefit of these subsidies given in the form of social costs goes to the consumers of these commodities. The major part of these costs in Punjab are incurred on the growing of rice and also wheat, which are sold at more than 90% of MSP to the government procurement agencies, and these grains are consumed outside of Punjab; the government of Punjab is therefore subsidizing the consumers of the other states, and not their own farmers.

Farmers of Punjab remain under an illusion that they are receiving subsidy in the form of a free electricity supply to the tube-wells. They are in fact serving as a conduit for the power subsidy flowing to the consumers of the other states. Thus, Punjab state is subsidizing the consumers of food grains in other states, not the Punjab farmers, despite the huge social costs incurred every year. There is a need for the farmers to realize that they are living under an illusion, and also for the state government to realize that they are wasting precious resources, which is placing the farmers and other sectors of the society at a tremendous disadvantage. A consequence is the state's mounting debt, below normal functioning of the secondary and tertiary sectors of the economy, domestic sector suffering, and, above all, a drain on resources for additional production of power and its inefficient transmission to the consumers of power. Farmers' costs also increase, because the inadequate-quality supply of electric power forces them to use diesel pumps, which are a very high cost proposition. Over-exploitation of ground water and its inefficient use because of free power supply has adversely affected the water balance of the state, and

the water table in central Punjab is receding by more than 2 feet every year. As a result, the farmers are resorting to submersible pumps, which imposes quite a heavy cost in itself. More importantly, when a submersible pump is installed, the water supply in the adjoining shallow pumps is adversely affected. Thus the small farmers, who may not have sufficient resources for installing the submersible pumps, suffer a great deal. The situation thus becomes unsustainable.

3. POLICY PRESCRIPTIONS

Subsidies play an important role in a welfare state in the context of income transfer to the disadvantaged sections of the society. Yet in order to achieve this objective, the following points need to be adhered to.

- Subsidies must be targeted to reach the deserving beneficiaries only.
- Undifferentiated across-the-board subsidies do not serve the purpose and amount to diverting the flow of scarce resources to unintended recipients.
- The subsidies should be temporary in nature so that vested interests are not created which would try to continue the subsidies beyond their necessity.
- Subsidies should be partial and never absolutely free, which will restrain the user from overuse and misuse of the subsidized items.
- As far as possible, the subsidies should be of an investment type that generate and improve the capacity of the beneficiaries to be independent.
- Subsidies should constitute the bare minimum and should continue only as long as is absolutely necessary.
- Consumer subsidies should be given directly to the intended beneficiaries in the form of food stamps, to avoid pilferage of rationed goods and to provide the consumer with a choice of the food items he/she would like to purchase.
- Farm subsidies should preferably be investment subsidies that improve productivity, production, and efficiency of resource use such as land development, laying of underground water channels, purchase of machinery and appropriate implements, installation of tube-wells, etc.
- Input subsidies that promote over-exploitation of scarce resources, such as the underground water table, and cause environmental degradation such as poisoning of soils and pollution of air and water should be avoided and, if considered essential, should be restricted to the minimum necessary. This category includes supply of electric power, fertilizers, pesticides, etc.
- If the subsidies are necessary for promotional purposes, the subsidies should be partial. No subsidies should be supplied absolutely free. For instance, if electric power for the farm sector is to be subsidized, it should be partial and on metered supply of power. A flat-rate system is as harmful as a free supply, because, after paying flat-rate charges, the user applies no restraint and over-exploits and even misuses the scarce resource.

- Subsidies should be targeted to the small and marginal farmers only. Across-the-board undifferentiated subsidies carry no economic logic. Such a system of subsidies tends to gravitate towards the undeserving large farms.
- It needs to be realized that, for the commodities that are procured by the national government (mainly food grains) at minimum support prices and to the extent that the cost of cultivation of these commodities enters into the calculations for determining these prices, the system does not allow the subsidies to flow into the pockets of producers. Since cost estimates account for only the actual costs incurred by the producer, the cost of production estimates include only the subsidized costs. For subsidies such as power supply, the cost to the farmers is counted as zero. Accordingly the support prices remain low and benefit flows to the consumers in the form of lower issue prices, not to the farmers.
- Input subsidies can also be given to the targeted beneficiaries directly in the form of *security printed input stamps*, and it should be left to the farmer to decide which combination of inputs he would like to purchase with these stamps. In this case market prices should prevail for the inputs used by the farmers. This will target the beneficiaries, improve their input management capacity, and would provide a check on excessive use and misuse of scarce resources.

It needs to be realized that, unfortunately, any benefit to the farm sector in the form of subsidies or higher prices translates mainly into the escalation of land rent, and the actual cultivators, especially the tenants, suffer in the process; hence there is a need to effectively implement the rent control provisions of the law.