



Economic Analysis of Subsidies in India

Dr. Manjushri Gupta

Professor

Department of Economics

Government Girls College, Ajmer

INTRODUCTION :

WHAT IS SUBSIDY ?

The Oxford English Dictionary defines subsidy as money granted by state, public body etc. to keep down the prices. A subsidy is often viewed as the converse of a tax. Derived from the Latin word 'Subsidium' literally coming to assistance from behind.

In economics, a subsidy is a form of financial assistance paid to a business or household sector. When a loan is subsidized it means the borrower does not pay interest when repaying the loan. A subsidy can be used to support business that might otherwise fail, or to encourage activities that would otherwise not take place. Subsidies can be regarded as a form of protectionism or trade barrier by making domestic goods and services competitive against imports. Subsidies may distort markets, and can impose large economic costs. Financial assistance in the form of a subsidy may come from government, but the term subsidy may also refer to assistance granted by others, such as individuals.

Subsidy is a grant of money made by the government to either a seller a buyer of certain product or service, thereby changing the price or cost in a way which affects the output. In fact, it is a payment reducing the buyer's price below the cost i.e. a negative tax and the difference between two is the amount of subsidy. The effect of a subsidy on the quantity produced and consumed is just the opposite of the effect of a tax- the quantity will increase. Like a tax, the benefit of a subsidy is split

between buyers and sellers, depending on the relative elasticities of supply and demand to explain the benefits that occurs to buyers' sellers.

A cash payment to producers/consumers is an easily recognisable form of a subsidy. However, it also has many invisible forms. Thus, it may be hidden in reduced tax-liability, low interest government loans or government equity participation. If the government procures goods, such as food grains, at higher than market prices or if it sells at lower than market prices, subsidies are implied.

Forms of Subsidies

- 1) **Direct Subsidy:** Direct subsidies are the most simple, and arguably the least frequently used. They involve a direct cash transfer to the recipient, for example when an unemployed person is paid unemployment benefit in cash.
- 2) **Indirect Subsidy:** Indirect subsidy is a term sufficiently broad that it may cover most other forms of subsidy. The term would cover any form of subsidy that does not involve a direct cash transfer.

Aims of the Subsidy

Subsidies are often aimed at :

- a) Inducing higher consumption and production
- b) Offsetting market imperfections including internalization of externalities:
- c) Achievement of social policy objectives including redistribution of income, population control, etc.

Effects of Subsidies

Economic effects of subsidies can be broadly grouped into

- 1) **Allocative effect:** These relate to the sectoral allocation of resources. Subsidies help draw more resources towards the subsidized sector from non-subsidized sectors.
- 2) **Redistributive effect:** These generally depend upon the elasticity's of demands

of the relevant groups for the subsidized good as well as the elasticity of supply of the same good

- 3) **Fiscal effect:** Subsidies have obvious fiscal effects since a large part of subsidies emanate from the budget. They direct increase fiscal deficits.
- 4) **Trade effects:** a regulated price, which is substantially lower than the market clearing price, may reduce domestic supply and lead to an increase in imports.

Mode of Administering a Subsidy

The various alternative modes of administering a subsidy are:

- Subsidy to Producers
- Subsidy to Consumers
- Subsidy to Producers of Inputs
- Production/ sales through Public Enterprises
- Cross Subsidization

Transfers and Subsidies

Transfers which are straight income supplement need to be distinguished from subsidies. An unconditional transfer to an individual would augment his income and would be distributed over the entire range of his expenditures. A subsidy however refers to a specific good, the relative price of which has been lowered because of the subsidy with a view to changing the consumption/allocation decisions in favour of the subsidised goods. Even when subsidy is hundred percent, i.e. the good is supplied free of cost, it should be distinguished from an income-transfer (of an equivalent amount) which need not be spent exclusively on the subsidised good. Transfers may be preferred to subsidies on the ground that (i) any given expenditure of State funds will increase welfare more if it is given as an income-transfer rather than via subsidising the price of some commodities, and (ii) transfer payments can be better targeted at a specific income groups as compared to free or subsidised goods.

Subsidy Issues in India

Subsidies have proliferated in India for several reasons. In particular this proliferation can be traced to (1) the expanse of governmental activities (2)relatively weak determination of governments to recover costs from the respective users of the subsidies, even when this may be desirable on economic grounds, and (3) generally low efficiency levels of governmental activities.

Sectoral Distribution of Subsidy

(i) Agriculture Subsidy: It is a governmental subsidy paid to farmers and agribusinesses to supplement their income and manages the supply of agriculture commodities and influence the cost supply of such commodities. It is provided to secure food supply (supply sufficiently), guarantee high quality standards and positives impact of agriculture on society.

(ii) Fertilizer Subsidy: It is provided with the objectives of making available fertilizers to farmers at affordable prices and to promote balanced application of three main fertilizer nutrients viz. nitrogen, phosphorus and potash, urea, being the only controlled fertilizer, is sold at statutorily notified uniform sale price, and decontrolled phosphatic and potassic fertilizers are sold at statutorily notified uniform sale price, and decontrolled phosphatic and potassic fertilizers are sold at indicative Maximum Retail Prices (MRP). These such sale prices are far less than the cost of production of fertilizers.

(iii) Export Subsidy: Export subsidies are payment made by the government to encourage the export of specified products. As with taxes subsidies can be levied on a specific or ad valorem basis. The most common product groups where export subsidies are applied are agricultural and dairy products.

(iv) Food Subsidy : Food subsidy is offered to maintain price stability; provide support to poor; and ensure adequate returns to small and marginal farmers. It comprises subsidies to farmers through minimum support prices (MSPs) and purchases

operations of the Food Corporation of India; consumer subsidies through the public distribution system, and subsidies to FCI to cover all its costs.

(v) Electricity subsidy: In case of electricity, the subsidy rates have been rising for both agriculture and domestic sectors because the unit cost has been rising faster than the relevant tariff-rate, Also, there is considerable variation in the level of per capita electricity subsidy indicates that, in the richer States, the per capita subsidy is substantially higher as compared to that in the poorer States.

(vi) Petroleum Subsidy : The system of subsidy for domestic LPG, PDS Kerosene, HSD and Kerosene is an issue of greatest concern for the oil marketing public sector units and for consumers today due to volatile crude oil prices, which has been fluctuating from the \$ 45 barrel to \$150 barrel and back to \$ 30 per barrel in last two years. Government is giving support to oil marketing PSUs for other two products namely Petrol and Diesel (HSD) so that the consumers can be protected from the volatility in the crude prices which means it is subsidy to consumers.

(vii) Miscellaneous Items' Subsidy : The other items where the government provide subsidy includes debt relief to farmers, grants to NAFED, subsidy on Railways and Import/Export of sugar. The amount of other subsidies during 2014-15 was Rs. 9310 crores.

Review of work already done on the subject of proposed

Research Study :

(1) Ahluwalia, Deepak (1993): in this article entitled "Public Distribution of Food in India: Coverage, Targeting and Leakages - Food Policy", analyses that evidence underlying concerns related to the coverage and performance of the Indian Public Distribution System. The broad conclusions are that leakages into the free market are a serious problem, as is the weak targeting in the programme.

(2) Suryanaravana. M. H. (1995): in his article entitled "Public Distribution of Food in India: A Clarification, Food Policy", revealed that in a recent note in this journal on the public distribution of food in India, Howes and Jha disputed a view earlier advanced by them that there 'is no evidence of any serious urban bias' in the

system. This pole recapitulates the rationale for the measure used by them to evaluate the system and clarifies why they believe the issue of rural-urban bias is somewhat redundant, and what kind of policy mix is needed to address the objectives served by the public distribution system.

(3)Panagariya Arvind (2000) in his article entitled "Evaluating Case for Export Subsidy" explains that with import-substitution policies discredited, many have argued for interventions on behalf of export interests. He concludes that under perfect competition, a country trying to retaliate against a trading partner's export subsidies by instituting its own export subsidies will only hurt itself. The argument that export subsidies may be useful for neutralizing import tariffs is spurious. In most practical situations, this is not possible. Removal of tariffs is a far superior policy. In principle a case can be made for protecting infant export industries in the presence of externalities.

(4) Negotiating Group on Rules DOHA RoundProposal (2003): "Subsidies Disciplines Requiring Clarification and Improvement from the US" highlights that there are a number of proposals in play in the Doha Round negotiations on subsidies. Probably the most important achievement of the Uruguay Round negotiations on subsidies is the definition of subsidies contained in Article 1 of the *SCM Agreement*. The exhaustive list of types of subsidies that can constitute financial contributions by a government is important because it provides a high degree of certainty and predictability about what types of government practices will be considered to be subsidies.

(5) Tim Pal Parthapra (2005) in his article entitled "**Current WTO Negotiation on Domestic Subsidies in Agriculture: Implication for India**" highlights that in the Doha Development Round of trade talks, agriculture has emerged as one of the most important issues for negotiations. Developing countries are particularly concerned about the widespread use of domestic farm subsidies by developed countries. Estimates suggest that domestic farm support in developed countries amounts to

about 300 billion US dollars. Such huge subsidies not only create distortion in the domestic markets of these countries, they also distort trade by artificially influencing commodity prices. One of the priorities of the current round of WTO negotiations is to bring substantial reduction in trade distorting domestic support. This paper analyses the present state of play of WTO negotiations and evaluates how effective the current. WTO provisions will be to reduce domestic subsidies in developed countries.

(6) Myers Norman (2007) in his article entitled "Ecological Economics" highlights that many subsidies are "perverse" in that they are harmful to both the economy and the environment According to him subsidies for coal mining are so large that it would be economically efficient for the government to close down all the mines and send the workers home on full pay for the rest of their lives. The environment would benefit too: less coal pollution such as acid rain and global warming. Subsidies for agriculture foster over-loading of croplands, leading to erosion of topsoil, pollution from synthetic fertilizers and pesticides, and release of greenhouse gases. They also studied impacts of fuel and transport subsidy.

Bibliography

- **Badiani, Reena and Katrina K. Jessoe (2011)**, "Electricity Subsidies for Agriculture: Evaluating the Impact and Persistence of these Subsidies in India", Economic and Political Weekly, Vol.4, No.5, PP 203-210, September 22
- **Bajpai, A.D.N. and S.K. Shivastava (1991)**, "Relevance of subsidies in determining fertilizer consumption in Indian agriculture-An economic analysis", Journal of Rural Development, Vol. 10, No. 4, PP 391-403, May 4
- **Bala, Brij, and R.K. Sharma (2005)**, "Factors influencing fertilizers production and consumption in India", Indian Journal of Agricultural Research", Vol. 39, No. 2, PP. 146-149

- **Barman, Kiran (2005)**, "The problem of budgetary subsidies in India", Economic Affairs, Vol. 27, No. 4-6, PP371-372, April-June
- **Bathla, Seema (1997)**, "Ground Water Sustainability: A case study of Ludhiana District", Indian Journal of Agricultural Economic, Vol. 4, No. 6, PP 56-60, April 3.
- **Bhalla, G. S. (2004)**, "Globalisation and Indian Agriculture, State of the Indian Farmer: A Millennium Study", Economic and Political Weekly, Volume 1, No. 4, PP 70-73, Dec 12
- **Bhalla, G.S. and Gurmail Singh (2009)**, "Economic Liberalisation and Indian Agriculture: A State-wise Analysis", Economic and Political Weekly, December, Vol. 25, No. 52, PP 78-84, Jan 4
- **Birner, Regina, Surupa Gupta and Neeru Sharma (2011)**, "The Political Economy of Agricultural Policy Reform in India: Fertilizers and electricity for irrigation", IFPRI (International Food Policy Research Institute), PP 56-61, Dec 12
- **Chander, Satish (2005)**, "India's Fertiliser Policy and Scope for Reforms", Economic and Political Weekly, Vol. 2, No. 1, PP 31-42, March 3
- **Chattopadhyay, P. (2004)**, "Cross Subsidy in Electricity Tariff: Evidence from India", Energy Policy, Vol. 32, No. 5, PP 673-684, July 23
- **Dillion, G.S. (2008)**, "Subsidies yes, but no freebies", Indian Express, June 18
- **Dubash, N K and S C Rajan (2001)**, "Power Politics: Process of Power Sector Reforms in India", Economic and Political Weekly, Vol.36, No. 35, PP 3367-3390, Sep. 1
- **Fukumi, Atsushi (2007)**, "The Effects of Political Instability on Power Subsidies: An Analysis of Indian States", Economic and Political Weekly, Vol. 2, No. 3, PP 134-140, Nov. 23.
- Government of India, Central Statistical Organisation, New Delhi.
- Government of India, Economic Survey, Various years.
- Government of India, Fertilizer Association, fertilizer statistics, various issues, New Delhi.
- Government of India (1979), Report of committee on control and subsidies, Vol. 1 to 3, Ministry of finance, New Delhi.